

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress



In the Matter of:

Determination of Rates and Terms for
Making and Distributing Phonorecords
(Phonorecords III)

Docket No. 16-CRB-0003-PR (2018-2022)

**AMAZON DIGITAL SERVICES LLC, GOOGLE INC., PANDORA MEDIA, INC., AND
SPOTIFY USA INC.'S COUNTER-DESIGNATIONS TO COPYRIGHT OWNER'S
DESIGNATION OF PHONORECORDS I TESTIMONY**

Pursuant to this Court's order on March 29, 2017, Amazon Digital Services LLC ("Amazon"), Google Inc. ("Google"), Pandora Media, Inc. ("Pandora"), and Spotify USA Inc. ("Spotify") (collectively, the "Services") hereby counter-designate the below testimony from the *Phonorecords I* proceeding in response to the National Music Publishers' Association and the Nashville Songwriters International Association's (collectively, the "Copyright Owners") motion to admit Exhibits 321 and 322 (*Phonorecords I* testimony of Timothy Quirk and Daniel Sheeran, respectively).¹

Sheeran Testimony:

6157:8-22.
6169:2-6172:22
6179:15-6180:10
6182:16-6183:20
6187:15-6189:1

Quirk Testimony:

4614:21-4616:9
4619:18-4623:10

Additionally, the Services object to the Copyright Owners' designation of the colloquy at 6235:21-6240:8 as irrelevant.

¹ For the Copyright Royalty Judges' convenience, attached as Appendix A is a highlighted version of the hearing transcripts containing the testimony of Messrs. Sheeran and Quirk. Highlighted in yellow are the designations by the Copyright Owners; in blue are the designations by the Services.

Dated: April 7, 2017

Respectfully submitted,

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Appendix A

Trial Testimony of Daniel Sheeran

Services Designations (Blue)

Copyright Owner Designations (Yellow)

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4 (Pages 6150 to 6153)

Page 6150		Page 6152	
1	JUDGE ROBERTS: All right.	1	court where you are employed?
2	MR. SMITH: The only thing we're	2	A. I am employed at Real Networks in
3	asking you to do right now is to allow	3	Seattle.
4	Mr. Laguarda to put Mr. Quirk off until	4	Q. And how long have you worked at
5	tomorrow.	5	Real Networks?
6	CHIEF JUDGE SLEDGE: He is the	6	A. It will be seven years this coming
7	third witness in line. So you're suggesting	7	August.
8	that he would be reached before tomorrow?	8	Q. What is your current position
9	MR. SMITH: I believe that the two	9	there?
10	witnesses before him are pretty short, so we	10	A. I am senior vice president of
11	are concerned that that would happen, Your	11	business development.
12	Honor.	12	Q. What are your responsibilities in
13	MR. COHEN: And copyright owners	13	that position?
14	are prepared to put Mr. Faxon on this	14	A. I oversee the negotiations of our
15	afternoon, so we don't waste any part of the	15	major corporate partnerships with a principal
16	court's day.	16	focus on the music business.
17	CHIEF JUDGE SLEDGE: Okay. So the	17	Q. If I can remind you to speak up
18	question then, as I understand it, is whether,	18	because there is no amplification in the
19	at the end of Emmer's testimony, then DiMA	19	courtroom.
20	gets charged with the rest of the afternoon,	20	A. Okay.
21	or whether we take an owners' witness out of	21	Q. What have been your prior positions
22	turn. That's the question we have to decide.	22	at Real Networks?
Page 6151		Page 6153	
1	MR. COHEN: Yes.	1	A. Until about one year ago I was SVP
2	MR. SMITH: Yes, Your Honor.	2	of the music business, so I had worldwide
3	CHIEF JUDGE SLEDGE: All right. We	3	responsibility for our music business for
4	will address that at the next break.	4	approximately two years. For the
5	MR. LAGUARDA: Very well. Thank	5	approximately two years prior to that, I was
6	you, Your Honor. At this time, the Digital	6	the senior vice president of our international
7	Media Association calls Daniel Sheeran.	7	business, so I was responsible for all of the
8	CHIEF JUDGE SLEDGE: Raise your	8	revenue and operations of our businesses
9	right hand.	9	outside of the United States and Canada.
10	Whereupon,	10	Before that, I ran marketing for
11	DANIEL SHEERAN,	11	the company.
12	called for examination by counsel, and having	12	Q. And prior to being employed at Real
13	been first sworn by the Chief Judge, was	13	Networks, where were you employed?
14	examined and testified as follows:	14	A. I was employed for approximately
15	CHIEF JUDGE SLEDGE: Thank you.	15	eight years at a company called nCUBE and a
16	Please be seated.	16	predecessor to that company. nCUBE is a
17	DIRECT EXAMINATION	17	supplier of computer software and hardware to
18	BY MR. LAGUARDA:	18	the cable television industry.
19	Q. Good afternoon. Could you please	19	Q. And could you give the court a
20	state your name for the record.	20	summary of your educational background?
21	A. My name is Daniel Sheeran.	21	A. I received a bachelor of science in
22	Q. Mr. Sheeran, could you tell the	22	foreign service from Georgetown University and

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5 (Pages 6154 to 6157)

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<p>1 I received an MBA from Northwestern 2 University. 3 MR. LAGUARDA: May I approach, Your 4 Honor? 5 CHIEF JUDGE SLEDGE: Yes. 6 BY MR. LAGUARDA: 7 Q. Mr. Sheeran, I have placed in front 8 of you what has been marked for identification 9 as DiMA Trial Exhibit 11. Do you have that in 10 front of you? 11 A. Yes. 12 Q. Can you tell us what it is? 13 A. This is my rebuttal testimony. 14 Q. And turning to the back, are those 15 the exhibits that are attached or cited in 16 your testimony? 17 A. Yes, they are. 18 Q. Would you turn to the last numbered 19 page of your testimony, or the last page 20 following the last numbered page. Is that 21 your signature? 22 A. Yes, it is.</p>	<p>1 summarize and explain that to the court? 2 A. Yes. We need to make significant 3 investments in developing our products, 4 increasing their ability to work on other 5 devices so that the Rhapsody service can be 6 accessed not just on the PC. That's an area 7 of a tremendous amount of work for us. 8 We need to improve the product 9 experience on the PC because of the 10 competition we face from both illegal services 11 and other legal services. 12 We also need to invest heavily in 13 marketing our service in order to educate 14 consumers about our value proposition and our 15 brand. 16 Q. Can you explain what you mean by 17 marketing? 18 A. We conduct several forms of 19 marketing. We do traditional advertising 20 on-line, on television and in magazines to 21 raise consumer awareness of what Rhapsody is, 22 how it's different than a pure download store,</p>
Page 6155	Page 6157
<p>1 Q. Do you have any corrections or 2 changes to make to the testimony at this time? 3 A. No, I do not. 4 Q. Mr. Sheeran, are the contents of 5 your written testimony, DiMA Trial Exhibit 11, 6 true? 7 A. Yes. 8 MR. LAGUARDA: Your Honor, I would 9 move to admit DiMA Trial Exhibit 11. 10 CHIEF JUDGE SLEDGE: Any objection 11 to Exhibit 11? 12 MR. JOHNSON: No, Your Honor. 13 CHIEF JUDGE SLEDGE: Without 14 objection, it's admitted. 15 (DiMA Trial Exhibit No. 11 was 16 received into evidence.) 17 BY MR. LAGUARDA: 18 Q. Mr. Sheeran, in the introductory 19 part of your testimony you talk about 20 investments that Real Networks is anticipating 21 to make in the subscription music business 22 over the next several years. Can you</p>	<p>1 and to generate name familiarity. 2 We also conduct what's called 3 sponsored search marketing on-line through 4 Google and other search engines where, when 5 consumers are searching for music, we can let 6 them know about Rhapsody in that highly 7 contextual environment. 8 Q. Is it important to Rhapsody to make 9 these investments that you're describing? 10 A. It's critical for several reasons. 11 In addition to the reasons that I mentioned a 12 minute ago, we're also contractually obligated 13 to do a certain level of marketing because of 14 our partnerships. A core tenet of our 15 strategy is to distribute Rhapsody through 16 major partners like Best Buy, Verizon and 17 Comcast. And in many of those agreements the 18 partner, in order to decide to get behind 19 Rhapsody and make it their primary or the 20 exclusive music service that they're going to 21 promote, requires that we commit to a certain 22 level of marketing spend.</p>

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<p>1 Q. Do you believe that you could</p> <p>2 postpone or defer the investments that you've</p> <p>3 described in the next five-year period?</p> <p>4 A. No, I do not.</p> <p>5 Q. Can you explain why?</p> <p>6 A. Well, on the product development</p> <p>7 side, as I mentioned, we urgently need to</p> <p>8 enable Rhapsody beyond the PC, because we have</p> <p>9 found that while the value proposition of</p> <p>10 Rhapsody is very compelling for many</p> <p>11 consumers, there is a much larger set of</p> <p>12 consumers who have told us through interviews</p> <p>13 we have done and anecdotal research that we</p> <p>14 need to make the product more easily available</p> <p>15 in the two places that consumers most often</p> <p>16 enjoy music, which is in their car and in</p> <p>17 their living room.</p> <p>18 So we have a tremendous amount of</p> <p>19 work that we have to do right now to make that</p> <p>20 possible, by getting the service onto devices</p> <p>21 in the car, mobile phones, devices that play</p> <p>22 music through the living room.</p>	<p>1 BY MR. LAGUARDA:</p> <p>2 Q. Mr. Sheeran, are you familiar with</p> <p>3 the rates proposed and the terms proposed by</p> <p>4 the copyright owners in this proceeding?</p> <p>5 A. Yes, I am.</p> <p>6 Q. I have placed in front of you what</p> <p>7 has been marked for identification as DiMA</p> <p>8 Trial Exhibit 12. Do you have that?</p> <p>9 A. Yes, I do.</p> <p>10 Q. Do you recognize --</p> <p>11 A. Yes.</p> <p>12 Q. Do you recognize what is DiMA Trial</p> <p>13 Exhibit 12?</p> <p>14 A. Yes.</p> <p>15 Q. Can you tell the court what it is?</p> <p>16 A. It's a summary of the proposed</p> <p>17 rates that the copyright holders are</p> <p>18 proposing.</p> <p>19 Q. Mr. Sheeran, do you have a view as</p> <p>20 to whether, if these rates were adopted by the</p> <p>21 copyright royalty judges in this proceeding,</p> <p>22 if they would have an adverse impact on Real</p>
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<p>1 On the marketing side, as I said,</p> <p>2 we need to compete with the illegal free</p> <p>3 services, make sure consumers are aware that</p> <p>4 our service is a better proposition, and</p> <p>5 easier for them, and legal. We also need to</p> <p>6 compete with the other legal services, some of</p> <p>7 which only offer downloads.</p> <p>8 So if we don't explain to the</p> <p>9 consumer why our proposition is different and,</p> <p>10 in some ways, better, they will not even know</p> <p>11 that we exist. At a time when most consumers</p> <p>12 are making their major initial commitments to</p> <p>13 how they're going to transition from the</p> <p>14 historical way they've acquired music to the</p> <p>15 digital world, this is a critical window for</p> <p>16 us to get in front of them and let them know</p> <p>17 who we are, both to make them commit to a</p> <p>18 legal approach to begin with, and to make sure</p> <p>19 they understand our proposition in particular.</p> <p>20 MR. LAGUARDA: Your Honor, may I</p> <p>21 approach?</p> <p>22 CHIEF JUDGE SLEDGE: Yes, sir.</p>	<p>1 Networks?</p> <p>2 A. Yes.</p> <p>3 Q. Can you explain why?</p> <p>4 A. Well, the --</p> <p>5 CHIEF JUDGE SLEDGE: I'm sorry.</p> <p>6 Explain why what?</p> <p>7 BY MR. LAGUARDA:</p> <p>8 Q. I'm sorry. Can you explain the</p> <p>9 basis for your belief as to the adverse impact</p> <p>10 on Real Networks?</p> <p>11 MR. JOHNSON: Objection.</p> <p>12 CHIEF JUDGE SLEDGE: He's asking if</p> <p>13 he had a belief -- I don't think he said he</p> <p>14 had -- he said yes, but I don't think he has</p> <p>15 told you what his belief is.</p> <p>16 MR. LAGUARDA: I'm sorry, Your</p> <p>17 Honor.</p> <p>18 MR. JOHNSON: That was my</p> <p>19 objection.</p> <p>20 MR. LAGUARDA: I will rephrase.</p> <p>21 BY MR. LAGUARDA:</p> <p>22 Q. Mr. Sheeran, can you please explain</p>

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1 to the court what your belief is.	1 download is 99 cents. There is tremendous
2 A. I believe the copyright holders'	2 pressure in the market today for retail prices
3 proposal will have a tremendously negative	3 to decrease. Amazon has come into the market
4 impact on our music business. It would be	4 and had lower prices on both individual tracks
5 difficult for me to see, frankly, how we would	5 and albums, on average, than iTunes and
6 ever get our music business to become	6 ourselves.
7 profitable if these rates were adopted.	7 Wal-Mart has been in the market
8 Q. In your testimony, you describe,	8 with a lower-priced product and has been
9 with respect to permanent downloads, the	9 threatening to also lower their prices on
10 impact of the copyright owners' proposal. And	10 physical CDs, which would, we believe, have an
11 I would just like to ask you, Real Networks	11 impact on how much we could charge in the
12 sells permanent downloads; is that right?	12 digital world.
13 A. Yes.	13 If we had to bring our retail price
14 Q. Can you explain to the court --	14 down to 89 cents per track -- which is where
15 summarize the impact of the copyright owner	15 Amazon and Wal-Mart sell many of their
16 proposal on the business of selling permanent	16 individual tracks -- and we had to accommodate
17 downloads for Real Networks?	17 the higher mechanical royalty, our margin --
18 A. Yes. Today, our download business	18 our profit margin in downloads would become
19 has a gross margin of just under 20 percent.	19 very close to zero.
20 That's a blend of the gross margin for our	20 Q. When you're referring to the
21 sale of a la carte tracks, individual tracks,	21 mechanical royalty, do you mean the copyright
22 as well as the margin for our sale of albums.	22 owner proposal for mechanicals?
Page 6163	Page 6165
1 Today, included in that cost is	1 A. Again, I am including the copyright
2 approximately 9 percent that is paid	2 owners' as well as an additional small amount
3 ultimately to the copyright holders by the	3 that comes in through the ASCAP ruling. Even
4 labels for the mechanical royalties.	4 the copyright owners' proposal alone would be
5 The proposal for -- the combination	5 6 percent -- would be 6 cents, from 9 to 15.
6 of the impact of the copyright holders'	6 If we have 20 to start with -- so that alone
7 proposal, which is for 15 percent, as well as	7 would be 6 out of the 20.
8 the recent ruling in a federal court in the	8 And then, if we also had to reduce
9 ASCAP case, would cause our total cost for	9 our retail prices, which we may well have to
10 mechanicals to go to somewhere around	10 because of what's happening in the
11 18 percent. So that would take our margin	11 marketplace, that would get us down to 2 to
12 from 20 percent down to 12 percent, so	12 3 percent [sic] in total. And then, if the
13 approximately a 40 percent impact in the gross	13 ASCAP ruling stands as is, it would go close
14 margin of our download business, which is	14 to zero.
15 obviously a tremendous impact.	15 Q. Let me ask you about the
16 Q. And do you have an understanding,	16 subscription part of your business. With
17 while that is happening, in terms of prices in	17 respect to the impact of the copyright owner
18 the market for permanent downloads, what the	18 proposal, do you have an understanding as to
19 trend is for prices to the consumer?	19 what the impact of the copyright owner
20 A. Yes. What I was just summarizing	20 proposal for conditional downloads and
21 was based on retail prices that we utilize	21 interactive streaming would be on your
22 today. Our average price for a retail	22 subscription music business?

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<p>1 A. Yes, I do.</p> <p>2 Q. Can you tell the court what that</p> <p>3 is?</p> <p>4 A. It would be a -- it would also be a</p> <p>5 very dramatic impact. The blended margin of</p> <p>6 our subscription business is about 37 percent</p> <p>7 gross margin. And the copyright holders'</p> <p>8 proposal -- I should back up and be clear.</p> <p>9 When I say blended, that's the</p> <p>10 blend of the Rhapsody Unlimited product we</p> <p>11 have today, which is a PC-only product, and</p> <p>12 our Rhapsody to Go product, which allows you</p> <p>13 to take conditional downloads off the PC onto</p> <p>14 portable devices.</p> <p>15 The average margin between those</p> <p>16 two, if you factor in which percentage of our</p> <p>17 subscribers are subscribing to each of those</p> <p>18 products, is around 37 percent. Today, the --</p> <p>19 that gross margin calculation utilizes the</p> <p>20 mechanical rate that we have been -- utilizes</p> <p>21 an assumption about publishing costs that we</p> <p>22 have been using for several years. It was</p>	<p>1 were counting on being able to grow the</p> <p>2 business rapidly to try to get to break-even.</p> <p>3 Q. I want to talk about that -- or get</p> <p>4 your testimony about that in a minute, but I</p> <p>5 want to ask you first, do you have an</p> <p>6 understanding as to what you are paying record</p> <p>7 labels for sound recording royalties for</p> <p>8 Rhapsody?</p> <p>9 A. Yes, I do.</p> <p>10 Q. And is it a lot more than what the</p> <p>11 copyright owners are proposing in this</p> <p>12 proceeding?</p> <p>13 A. It's more. I don't know whether I</p> <p>14 would characterize it as a lot more, but it's</p> <p>15 certainly more, yes.</p> <p>16 Q. Do you have a sense as to whether</p> <p>17 or not it would be fair to make a comparison</p> <p>18 between what you pay the record labels and</p> <p>19 what the copyright owners are proposing?</p> <p>20 MR. JOHNSON: Objection to leading,</p> <p>21 Your Honor.</p> <p>22 CHIEF JUDGE SLEDGE: Sustained.</p>
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<p>1 around 9 to 9-1/2 and then went up to</p> <p>2 10 percent about a year ago, I think is when</p> <p>3 we made the shift to 10 percent.</p> <p>4 The copyright holders' proposal for</p> <p>5 streaming is 12-1/2 percent, on top of which,</p> <p>6 again, we have to pay PROs, which is going to</p> <p>7 add another roughly 5 percent. So it would</p> <p>8 take what we have been assuming the rate would</p> <p>9 be, between 9-1/2 and 10 percent, and bring it</p> <p>10 up by an additional 7 to 8 percent.</p> <p>11 Because we're only starting out</p> <p>12 with 36, 37 percent, it, too, is a very</p> <p>13 significant impact. It's around a 21 percent</p> <p>14 hit to our gross margin. So it's not as</p> <p>15 severe as downloads, but it's still very</p> <p>16 significant to us.</p> <p>17 And I would also note that the</p> <p>18 downloads and the subscription services,</p> <p>19 particularly the to Go one, which already has</p> <p>20 a more difficult gross margin, are the two</p> <p>21 biggest sources of projected growth of the</p> <p>22 business. So it's hitting us right where we</p>	<p>1 BY MR. LAGUARDA:</p> <p>2 Q. You said you had an understanding</p> <p>3 as to what record labels charge for sound</p> <p>4 recordings; is that right?</p> <p>5 A. Yes, I do.</p> <p>6 Q. Is there a problem, in your view,</p> <p>7 as to -- paying copyright owners a higher</p> <p>8 rate, given what you pay record labels?</p> <p>9 MR. JOHNSON: Objection to form,</p> <p>10 Your Honor.</p> <p>11 CHIEF JUDGE SLEDGE: Overruled.</p> <p>12 THE WITNESS: Well, I would go back</p> <p>13 to my prior answer. The challenge we face --</p> <p>14 yes, we pay the labels a lot of money, on</p> <p>15 absolute terms and on a percentage term.</p> <p>16 There is no question about that.</p> <p>17 The challenge we face is that's</p> <p>18 something we have no control over. We cannot</p> <p>19 go back to them and say, well, we don't like</p> <p>20 your rate and, therefore, we're just not going</p> <p>21 to take a license from you.</p> <p>22 Our service is completely</p>

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<p>1 uncompetitive in the market if it doesn't have</p> <p>2 a broad range of content. And any one of the</p> <p>3 majors has a sufficient market share of the</p> <p>4 popular content that they can essentially</p> <p>5 demand that we pay these higher rates with the</p> <p>6 structures that we've agreed to.</p> <p>7 We have never felt it was the right</p> <p>8 thing, either for our business or, frankly,</p> <p>9 for the growth of the market -- there is a</p> <p>10 little bit of change starting there that we're</p> <p>11 hopeful about, but just to stick to the world</p> <p>12 that exists contractually today, that's the</p> <p>13 reality that we have had to live with.</p> <p>14 BY MR. LAGUARDA:</p> <p>15 Q. Do you believe that you could raise</p> <p>16 prices in response to increased rates from the</p> <p>17 Copyright Royalty Board?</p> <p>18 A. No, I do not.</p> <p>19 Q. Why is that?</p> <p>20 A. Well, I need to answer that both in</p> <p>21 the context of downloads and -- permanent</p> <p>22 downloads and subscription services that</p>	<p>1 services has slowed in the past two years. We</p> <p>2 have done a tremendous amount of price testing</p> <p>3 to figure out what is the right price that</p> <p>4 will allow us to grow the market. And we</p> <p>5 found two answers to that.</p> <p>6 One is the a la carte price needs</p> <p>7 to be quite a bit lower. And the second</p> <p>8 answer is by far the most effective way to</p> <p>9 grow the subscription part of the market would</p> <p>10 be to bundle the product in with something</p> <p>11 else the consumer is already buying, such as</p> <p>12 their high-speed internet service or their</p> <p>13 mobile phone service, if they're getting a</p> <p>14 data plan from their mobile phone carrier.</p> <p>15 In order for us to have any success</p> <p>16 with that strategy, which is really the</p> <p>17 linchpin of our growth strategy for our</p> <p>18 subscription business, we need lower costs.</p> <p>19 If we attempted to pass on higher</p> <p>20 costs in our negotiations with our partners,</p> <p>21 the cable operators, the mobile operators, we</p> <p>22 would be that much farther away from success.</p>
Page 6171	Page 6173
<p>1 include limited downloads. In the case --</p> <p>2 Q. Let's start with permanent</p> <p>3 downloads.</p> <p>4 A. In the case of permanent downloads,</p> <p>5 as I mentioned earlier, all the pressure in</p> <p>6 the market is actually in the opposite</p> <p>7 direction. We are frequently reconsidering</p> <p>8 whether we can even maintain our current</p> <p>9 price, given that Amazon came in with lower</p> <p>10 prices in the marketplace.</p> <p>11 In the case of -- and there have</p> <p>12 been -- back on downloads, there have been</p> <p>13 attempts in the past by others to raise prices</p> <p>14 where they have been retreated. You know,</p> <p>15 iTunes was trying to get a higher price for</p> <p>16 EMI's tracks and, you know, it looks like</p> <p>17 that's not going to be the long-term strategy</p> <p>18 that they stick with.</p> <p>19 So in the case of the subscription</p> <p>20 services, we are confident that lower pricing</p> <p>21 is one of the keys to really accelerating the</p> <p>22 market. The market growth of the subscription</p>	<p>1 CHIEF JUDGE SLEDGE: You said lower</p> <p>2 costs. Do you mean lower price?</p> <p>3 THE WITNESS: If we had higher</p> <p>4 costs because of higher mechanical rates, we</p> <p>5 would not be able to pass them on either in</p> <p>6 our consumer-facing a la carte business or in</p> <p>7 the relationships we have with the carriers</p> <p>8 where we're trying to get them to bundle</p> <p>9 Rhapsody. And -- we have just spent much of</p> <p>10 the last year, actually, in negotiations with</p> <p>11 one of the largest carriers in the United</p> <p>12 States, that I'd prefer not to identify by</p> <p>13 name, on precisely this issue. What does the</p> <p>14 cost need to be -- our -- I'm sorry: What</p> <p>15 does our price to them need to be? What does</p> <p>16 the cost need to become to them such that they</p> <p>17 would then -- their proposition could become</p> <p>18 for the customer, if you sign up for our</p> <p>19 service, it comes with Rhapsody?</p> <p>20 And we know that price is well</p> <p>21 under the retail price today for our service.</p> <p>22 So we have spent much of the past</p>

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<p>1 year actually going back to our suppliers and</p> <p>2 trying to get them to cut the price in</p> <p>3 exchange for our growing the market much more</p> <p>4 rapidly. And we have made good progress in</p> <p>5 those negotiations. We're not there. There's</p> <p>6 nothing to announce. There's no deal. It may</p> <p>7 never happen, but it's an example of all the</p> <p>8 discussion has been in the other direction,</p> <p>9 trying to get costs lower.</p> <p>10 And that's the reason why, in my</p> <p>11 written testimony, I point out the example of</p> <p>12 the cable industry took off 20, 30 years ago</p> <p>13 because they were able to get costs for their</p> <p>14 services low enough and bundle them in a way</p> <p>15 that, to the consumer, it was just one simple,</p> <p>16 easy decision. Had they had to go</p> <p>17 a la carte -- and each of the services was</p> <p>18 very expensive, north of \$10 -- we wouldn't</p> <p>19 have the cable television industry that we</p> <p>20 have today.</p> <p>21 BY MR. LAGUARDA:</p> <p>22 Q. Mr. Sheeran, has the subscription</p>	<p>1 So no matter whether you're paying</p> <p>2 attention to operating income, net income or</p> <p>3 cash flow, you have a lot less gross margin to</p> <p>4 start with.</p> <p>5 Q. Mr. Sheeran, based on your</p> <p>6 testimony, do you believe that Real Networks</p> <p>7 would enter the subscription digital music</p> <p>8 business today if the copyright owner rates</p> <p>9 were adopted?</p> <p>10 A. Were we not in it already? Is that</p> <p>11 the question?</p> <p>12 Q. Were you not in it already.</p> <p>13 A. No.</p> <p>14 Q. Can you tell the court why?</p> <p>15 A. Well, as I said, I don't see how we</p> <p>16 would get -- it's not clear to me how we would</p> <p>17 get to profitability if all these rates were</p> <p>18 adopted, even standing where we are today</p> <p>19 where we have already made investments that</p> <p>20 we're able to leverage.</p> <p>21 So I think it would be that much</p> <p>22 more challenging had we not yet made those</p>
Page 6175	Page 6177
<p>1 music business Rhapsody been profitable to</p> <p>2 date?</p> <p>3 A. No.</p> <p>4 Q. How would you define profitability?</p> <p>5 A. Well, I could define it any of</p> <p>6 several ways, and it hasn't been profitable in</p> <p>7 any of them. It has not been profitable on an</p> <p>8 operating basis. It's not been profitable on</p> <p>9 a net profit basis. It's not been profitable</p> <p>10 on a cash flow basis.</p> <p>11 Q. Defined any of those ways, do you</p> <p>12 believe that the copyright owner proposal, if</p> <p>13 adopted, would delay profitability?</p> <p>14 A. Yes.</p> <p>15 Q. Why is that?</p> <p>16 A. Well, the economics that I walked</p> <p>17 through earlier today regarding the gross</p> <p>18 margin, all of that takes place in the top</p> <p>19 part of the income statement, so it doesn't</p> <p>20 matter what's happening down below; you've</p> <p>21 made everything worse by reducing your gross</p> <p>22 margin.</p>	<p>1 investments and we needed to build everything</p> <p>2 from scratch. I mean, I think -- that's</p> <p>3 probably enough.</p> <p>4 Q. Let me ask you, are you familiar</p> <p>5 with DiMA's proposed -- amended proposed rates</p> <p>6 and terms in this proceeding?</p> <p>7 A. Yes, I am.</p> <p>8 MR. LAGUARDA: May I approach, Your</p> <p>9 Honor?</p> <p>10 CHIEF JUDGE SLEDGE: Yes.</p> <p>11 BY MR. LAGUARDA:</p> <p>12 Q. Showing you what has been marked</p> <p>13 for identification as DiMA Trial Exhibit 13.</p> <p>14 Do you have that in front of you?</p> <p>15 A. Yes, I do.</p> <p>16 Q. Can you tell the court what it is?</p> <p>17 A. This is the proposal from DiMA for</p> <p>18 the new rates, as well as the terms used in</p> <p>19 those rates.</p> <p>20 Q. If I could just turn your attention</p> <p>21 to the definition -- section 380.2, definition</p> <p>22 of applicable receipts. Do you have that?</p>

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11 (Pages 6178 to 6181)

Page 6178	Page 6180
1 A. Yes, I do.	1 Q. Can you tell the court?
2 Q. Can you explain for the court the	2 A. Yes, we would.
3 rationale behind the definition of the	3 Q. And what about with respect to
4 applicable receipts?	4 tracking music usage, as DiMA proposes? Do
5 A. Well, the goal is to keep it	5 you have an understanding as to whether Real
6 simple, to implement this approach and also to	6 Networks could do that, track plays and sales
7 encourage experimentation in business models.	7 of downloads?
8 We're still fairly early in the transition to	8 A. Yes.
9 digital. We all need the market to grow more	9 Q. And can you tell the court?
10 quickly than it has, and we believe that the	10 A. Yes, we could.
11 way to encourage that is through rates that do	11 Q. One of the things you mentioned in
12 not impose constraints that would prevent	12 discussing the DiMA proposal is the use of
13 either an existing business from trying	13 minima. If I could ask you, for example, if
14 something new or a potential business from	14 permanent downloads were bundled with a device
15 getting created to go after a given market.	15 like a phone, do you have an understanding as
16 So we have tried to limit the	16 to how the DiMA rate proposal would work in
17 impact of things like minima, which we	17 that case?
18 think -- we have included to an extent, but we	18 A. Yes, I do.
19 think can be dangerous because they can crowd	19 Q. Can you tell the court?
20 out certain business opportunities.	20 A. Would the downloads be permanent or
21 We have also tried to be clear that	21 limited downloads?
22 there should not be a tax on other companies	22 Q. Permanent downloads.
Page 6179	Page 6181
1 that might be involved in a service that would	1 A. In the case of permanent downloads,
2 then get involved with digital music but are	2 then the minimums would apply, and because
3 not themselves the distributor of music, you	3 there's multiple downloads that are being
4 know, be that the manufacturer of an MP3	4 bundled, it would be the -- I believe it's
5 player, or a carrier, unless they themselves	5 3.3 cents per track rate.
6 were directly offering a service, you know,	6 Q. And what if a subscription service
7 clearly separate from the other product.	7 was bundled with a device? Do you have an
8 And we think that's important	8 understanding as to how the DiMA proposal
9 because we have been involved in many	9 would work?
10 negotiations with companies in those sectors	10 A. Yes. Then, again, the minimum for
11 who, at the mere mention of a tax in their	11 that would apply, which would be the
12 business, decide that it's just not worth --	12 13.5 cents per subscriber per month.
13 it's just not worth the risk to them because	13 Q. And if there is no monthly
14 their business is complicated enough as it is.	14 subscription fee, is there a mechanism in the
15 Q. By "a tax" do you mean t-a-x?	15 DiMA proposal for that?
16 A. I meant t-a-x, yes.	16 A. Yes. That would be the usage fee,
17 Q. Just to be clear.	17 which is .00129 dollars per play.
18 Do you have an understanding as to	18 Q. Could you explain to the court the
19 whether Real Networks would be able to track	19 purpose of the minima that DiMA is proposing?
20 revenues the way that DiMA has proposed in	20 A. The purpose is to make sure that
21 this proposal?	21 everybody's, for lack of a better term,
22 A. Yes, I do.	22 downside is protected. If something is tried

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12 (Pages 6182 to 6185)

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<p>1 and it takes off, we want to make sure that 2 everyone who contributed value to that gets 3 paid. It is not intended -- but that's all 4 it's intended to be. It's not intended to be 5 a way that everybody is going to get a 6 guaranteed return. 7 Again, we're so early in this 8 market that we simply can't know which models 9 are going to take off. So we think it serves 10 that purpose without crowding out at least the 11 business models that we can see. 12 We are familiar with consumer usage 13 rates on these products. And minima at higher 14 rates -- we have seen cases where they could 15 blow up the model before we even got started. 16 Q. What's your understanding of the 17 impact of the minima proposed by the copyright 18 owners? 19 A. Well, that's an example of where I 20 think it could blow up an opportunity before 21 we got started. I mentioned earlier that 22 the -- bundling our service with a carrier</p>	<p>1 * CHIEF JUDGE SLEDGE: Questions by 2 RIAA? 3 MR. SMITH: No thank you, Your 4 Honor. 5 CHIEF JUDGE SLEDGE: Cross-examine. 6 MR. JOHNSON: Yes, Your Honor. 7 Good afternoon. 8 CROSS-EXAMINATION 9 BY MR. JOHNSON: 10 Q. Good afternoon, Mr. Sheeran. My 11 name is Jeh Johnson. I represent the 12 copyright owners. 13 A. Good afternoon. 14 Q. Timothy Quirk, I assume you know 15 him, right? 16 A. Yes, I do. 17 Q. He is your colleague at Real 18 Networks? 19 A. Yes, he is. 20 Q. And you're aware that he testified 21 in this proceeding in the month of February, 22 correct?</p>
Page 6183	Page 6184
<p>1 service, be it high-speed data from a cable or 2 phone company or your mobile provider, is a 3 linchpin of our growth strategy. 4 We know that we must get the price 5 to the carrier of such an offering 6 substantially below where it is today. And we 7 know that based on the number of plays per 8 user that we see today on portable devices, 9 that the rates proposed by the copyright 10 holders would turn the payment for mechanicals 11 into a very significant percentage of the 12 total available for us to pay -- that we would 13 be able to collect from the carrier. 14 We would still need to then find, 15 from that, enough money to pay the labels as 16 well as additional money for us to cover our 17 own operating costs and get any kind of profit 18 margin. 19 So it would really render all of 20 those types of efforts largely useless. 21 MR. LAGUARDA: No further 22 questions. Thank you.</p>	<p>1 A. Yes. 2 Q. And what is his title with Real 3 Networks? 4 A. I believe he is vice president of 5 music programming. If it's not that, it's 6 something very close to that. 7 Q. Now, did anybody tell you what he 8 said in this proceeding? 9 A. I have had a chance to review some 10 of his testimony, not all of it. 11 Q. You read Mr. Quirk's testimony? 12 A. A small amount of it. 13 Q. Did you read his cross-examination? 14 A. I think I read a few exchanges, but 15 not the whole thing. 16 Q. Okay. Now, could you look at your 17 written statement, DiMA Exhibit 11, please? 18 And I want to spend some time with you on 19 paragraphs 6, 7 and 15 of your written 20 statement and try to get behind some of the 21 numbers here. 22 Let's focus on paragraph 6, please,</p>

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13 (Pages 6186 to 6189)

Page 6186	Page 6188
1 the bottom half of that paragraph which	1 A. Yes.
2 states, "We offer services that include	2 Q. And you know that your company has
3 permanent downloads, limited downloads and	3 been accruing, setting aside money to pay
4 interactive and non-interactive streaming.	4 mechanical rates, and that these companies
5 The operating costs of these businesses are	5 have been doing the same, correct?
6 very high for several reasons. First, the	6 A. Yes.
7 royalty payments we incur and/or accrue	7 Q. So you're not contending in this
8 account for more than half of our revenue" --	8 statement, by making this list of companies,
9 and then you go on to give two other reasons.	9 that these companies exited the market because
10 "Second, we faced high legal and	10 of mechanical royalties, are you?
11 technical costs in order to clear licenses,	11 A. If the question is, is that the
12 obtain physical copies of music, prepare the	12 sole reason they exited, then the answer is
13 music for delivery, store it, and deliver it	13 no. If the question is, is that part of the
14 to end users. Third, we must market our	14 reason they exited, the answer is yes.
15 services in an environment where many	15 Q. Well, was it your intent, by
16 consumers know that it is easy to illegally	16 listing these companies, to suggest that
17 download all the music they want."	17 mechanical royalties were the primary reason
18 And then in paragraph 7 you state,	18 they left this market?
19 "The impact of these three factors is clear.	19 A. I believe that the cost of content
20 In 2007, our music business achieved 149	20 is the primary reason why many of these
21 million in revenue, but had an operating loss	21 companies have left, and the cost of
22 of 60 million."	22 mechanicals is a very significant part of the
Page 6187	Page 6189
1 So you're not contending that you	1 problem of the cost of content.
2 had an operating loss of 60 million because of	2 Q. That would include sound recording
3 the royalties you have to pay, are you, all by	3 royalties, too, wouldn't it?
4 itself?	4 A. Yes.
5 A. Not all by itself.	5 Q. Okay. We will get to that also.
6 Q. You list these three factors here,	6 Have you read this court's decision
7 correct?	7 in the webcasting case about a year ago, by
8 A. I do, but I do not list them as	8 the way?
9 being of equal importance. The first one	9 A. I have read abstracts. I have not
10 accounts for more than half of our cost of	10 read the entire --
11 goods.	11 Q. Do you think it is the role of this
12 Q. Well, we're going to get to that.	12 court to protect an inefficient market actor?
13 We're going to get to a more specific analysis	13 Do you understand my question?
14 of that.	14 A. I do understand your question. No,
15 If you look at the next page,	15 that's not the role of this court.
16 please. And you list at the top of the page a	16 Q. So you're not contending that if a
17 set of companies -- Yahoo!, AOL, MTV Networks,	17 company is an inefficient market actor, this
18 Music Now, Virgin Media, MusicMatch and	18 court has to set a low mechanical rate in
19 Listen.com. Do you see that?	19 order to keep that company in the business,
20 A. Yes.	20 right?
21 Q. And those are companies that exited	21 A. No, I'm not making that argument.
22 this digital market, correct?	22 Q. Now, if you look at what I have

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14 (Pages 6190 to 6193)

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1 marked as Copyright Owners' Exhibit 280 for	1 Q. Okay. And if you look at the very
2 identification.	2 top line, net revenue -- by the way, when I
3 MR. JOHNSON: May I approach, Your	3 see the number net revenue, it's net of
4 Honor?	4 something. What is net revenue net of?
5 CHIEF JUDGE SLEDGE: Yes.	5 A. Typically, that would be net of
6 BY MR. JOHNSON:	6 items that are immediately credited back to
7 Q. Do you recognize Exhibit 280 for	7 the consumer. It's a small number, the
8 identification?	8 difference between net and gross. It's going
9 A. Yes.	9 to be, I think, 1 to 2 percent, typically,
10 Q. And this is the 10-K and annual	10 certainly for the music business, which is
11 report for your company, Real Networks, for	11 where I am familiar with the difference.
12 the year 2007, correct?	12 Q. And if you look at the net revenue
13 A. Yes.	13 number for the year 2005, you will see 325
14 Q. And when was this released?	14 million; is that correct?
15 A. Very recently I think it was	15 A. Yes.
16 released. Within the last handful of weeks.	16 Q. And if you look at the net revenue
17 Q. I'm sorry?	17 number for 2006, you will see that the number
18 A. Within the last handful of weeks.	18 rose by about 20, 25 percent, correct?
19 Q. Okay. I believe, if you look at --	19 A. Yes.
20 somewhere toward the back --	20 Q. To 395 million in 2006?
21 A. It was filed on February -- on	21 A. Yes.
22 2/29.	22 Q. And if you look at 2007, you will
Page 6191	Page 6193
1 Q. Okay. Let's take that date. And	1 see that the number rose by about 50 percent.
2 you recognize this document, correct?	2 if my math is correct, to 567 million in the
3 A. Yes.	3 year 2007, the net revenue number.
4 MR. JOHNSON: I offer Exhibit 280	4 A. Yes.
5 in evidence.	5 Q. All right. And the number in 2004
6 CHIEF JUDGE SLEDGE: Any objection	6 was lower than the number in 2005. Do you
7 to Exhibit 280?	7 remember that?
8 MR. LAGUARDA: No objection.	8 A. I do not know our 2004 revenue off
9 CHIEF JUDGE SLEDGE: Without	9 the top of my head, no.
10 objection, it's admitted.	10 Q. You don't know that offhand?
11 (Copyright Owners' Trial Exhibit	11 A. No.
12 No. 280 was received into evidence.)	12 Q. Okay. Now, if you look at the
13 BY MR. JOHNSON:	13 entries under operating expenses, you will see
14 Q. Mr. Sheeran, could you please look	14 that they're also rising as well, right?
15 at page 52 of this exhibit? It's not	15 A. Yes.
16 numbered, but it's right after page 51.	16 Q. 2005, research and development, 70
17 A. My page 52 is numbered. Is that	17 million. 2006, 77 million. 2007, 102
18 the right page, the consolidated statement of	18 million.
19 operations, comprehensive income -- is that --	19 And then if you look at the sales
20 Q. Yes. And these are company-wide	20 and marketing entries for 2005, it's 130
21 numbers, correct?	21 million. For 2006, 165 million. And then in
22 A. Yes.	22 2007, the number goes up by over 40 million to

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15 (Pages 6194 to 6197)

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<p>1 209 million. Do you see that?</p> <p>2 A. Yes.</p> <p>3 Q. Now, I heard what you said this</p> <p>4 morning about your contractual obligations</p> <p>5 with regard to sales and marketing. You're</p> <p>6 not telling this court that you're</p> <p>7 contractually obligated to spend these kinds</p> <p>8 of dollars every year at this level of</p> <p>9 increase, are you?</p> <p>10 A. No.</p> <p>11 Q. You're not contending that you're</p> <p>12 handcuffed to spend \$209 million in 2007 on</p> <p>13 sales and marketing?</p> <p>14 A. That's correct.</p> <p>15 Q. All right. Now, are you contending</p> <p>16 that if the court were to impose a 15 percent</p> <p>17 mechanical rate -- or a 15 cent mechanical</p> <p>18 rate -- for mechanical royalties, that you</p> <p>19 couldn't find that additional amount somewhere</p> <p>20 else in this balance sheet, in this statement?</p> <p>21 A. I am contending that it would be</p> <p>22 economically irrational for us to continue</p>	<p>1 A. Yes.</p> <p>2 Q. By a substantial amount? It</p> <p>3 depends on how you describe [sic] substantial,</p> <p>4 but would you agree with me that the number is</p> <p>5 going up each and every quarter for eight</p> <p>6 consecutive quarters?</p> <p>7 A. I'm sorry. Which page am I</p> <p>8 supposed to be looking at?</p> <p>9 Q. I am looking at the total net</p> <p>10 revenue line under supplemental financial</p> <p>11 information.</p> <p>12 A. Are we in the first page of --</p> <p>13 Q. First quarter '06 is 86 million.</p> <p>14 Second quarter, 89. Third quarter, 93.</p> <p>15 Fourth quarter, 125.</p> <p>16 Then into '07, 129, 136, 145 --</p> <p>17 A. Can you just tell me which page I'm</p> <p>18 supposed to be looking at --</p> <p>19 Q. I'm sorry.</p> <p>20 A. -- in the appendix?</p> <p>21 MR. JOHNSON: I'm sorry. May I</p> <p>22 approach?</p>
Page 6195	Page 6197
<p>1 focusing on a business where we have</p> <p>2 zero percent gross margins.</p> <p>3 Q. You couldn't squeeze that number</p> <p>4 out of some of these other numbers in the</p> <p>5 hundreds of millions?</p> <p>6 A. I couldn't make it up in volume if</p> <p>7 I'm not making any profit on each transaction.</p> <p>8 Q. Well, let's look at Exhibit A to</p> <p>9 your statement, please. Exhibit A is a --</p> <p>10 this is a public document, right?</p> <p>11 A. Yes, it is.</p> <p>12 Q. Okay. And was this prepared for</p> <p>13 this litigation or was it prepared in the</p> <p>14 normal course of business?</p> <p>15 A. Normal course of business.</p> <p>16 Q. Okay. And if you look at the top</p> <p>17 entries, net revenue, you will see entries</p> <p>18 there by quarter going back to 2006, then</p> <p>19 2007. And would you agree with me that the</p> <p>20 net revenue line, total net revenue line, for</p> <p>21 these eight consecutive quarters is rising</p> <p>22 every quarter?</p>	<p>1 CHIEF JUDGE SLEDGE: Well, all of</p> <p>2 us want to know that.</p> <p>3 MR. JOHNSON: I'm sorry.</p> <p>4 CHIEF JUDGE SLEDGE: You referred</p> <p>5 us to Exhibit A, and the first page of</p> <p>6 Exhibit A doesn't have anything that you are</p> <p>7 talking about.</p> <p>8 MR. JOHNSON: I'm sorry. This</p> <p>9 would be the -- on Exhibit A, this would be</p> <p>10 the fourth page, entitled, "Real Networks,</p> <p>11 Inc., and subsidiaries -- supplemental</p> <p>12 financial information."</p> <p>13 BY MR. JOHNSON:</p> <p>14 Q. Do you see that?</p> <p>15 A. Yes.</p> <p>16 Q. Okay. And do you see the quarterly</p> <p>17 reporting here?</p> <p>18 A. Yes.</p> <p>19 Q. Okay. Now, if you look at the</p> <p>20 fourth line down, total net revenue, would you</p> <p>21 agree with me that for eight consecutive</p> <p>22 quarters that number has gone up?</p>

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<p>1 A. Yes.</p> <p>2 Q. Now, if you look further down, you</p> <p>3 will see numbers by business segment,</p> <p>4 including the music business, right?</p> <p>5 A. Right.</p> <p>6 Q. Now, under "consumer products and</p> <p>7 services," you will see "music (F)," right?</p> <p>8 A. Right.</p> <p>9 Q. Now, what does that line represent?</p> <p>10 Is that net revenue for the music business?</p> <p>11 A. Yes.</p> <p>12 Q. All right. And would you agree</p> <p>13 with me that the net revenue line for the</p> <p>14 music business has also gone up eight</p> <p>15 consecutive quarters?</p> <p>16 A. Yes.</p> <p>17 Q. And that the total net revenue line</p> <p>18 there further down, that's the same as the one</p> <p>19 on the top, I believe, correct? It's about 12</p> <p>20 entries down.</p> <p>21 A. Yes, that's right. I would point</p> <p>22 out on the music line, although it's true that</p>	<p>1 from, right?</p> <p>2 A. Yes.</p> <p>3 Q. "The impact of these three factors</p> <p>4 is clear. In 2007, our music business</p> <p>5 achieved 149 million in revenue but had an</p> <p>6 operating loss of 60 million."</p> <p>7 A. (Nods head up and down.)</p> <p>8 Q. Okay. Now, you say in paragraph 6</p> <p>9 that "Royalty payments we incur" --</p> <p>10 JUDGE WISNIEWSKI: Before you get</p> <p>11 there, Mr. Johnson, I would like to ask a</p> <p>12 question or two here with respect to these</p> <p>13 revenue numbers and the operating loss numbers</p> <p>14 on page 2 that you report. I take it that --</p> <p>15 it seems to come out, from Mr. Johnson's</p> <p>16 cross-examination, that these effectively are</p> <p>17 numbers drawn from your consolidated</p> <p>18 statements.</p> <p>19 THE WITNESS: Yes.</p> <p>20 JUDGE WISNIEWSKI: Your</p> <p>21 consolidated statements are for the entire</p> <p>22 company, including your domestic and foreign</p>
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<p>1 the revenue increased -- revenue has been</p> <p>2 increasing through '06 and '07. What's not</p> <p>3 immediately clear from here, but I think is</p> <p>4 also relevant, is that the annual -- if you</p> <p>5 annualize this, from 2005 to 2006, the music</p> <p>6 business grew by about 45 percent. For the</p> <p>7 last two years it has grown by about</p> <p>8 21 percent per year.</p> <p>9 Q. Okay. Well, it's still growing,</p> <p>10 right?</p> <p>11 A. That's right.</p> <p>12 Q. And you had growth for eight</p> <p>13 consecutive quarters, right?</p> <p>14 A. Yes.</p> <p>15 Q. Okay. Now, if you add up the</p> <p>16 quarterly numbers for music in 2007, you get</p> <p>17 about 149 million, right?</p> <p>18 A. Yes.</p> <p>19 Q. And that's the number in your</p> <p>20 statement at page 2, paragraph 7, right?</p> <p>21 A. Yes.</p> <p>22 Q. That's where that number comes</p>	<p>1 subsidiaries?</p> <p>2 THE WITNESS: That's correct.</p> <p>3 JUDGE WISNIEWSKI: So there is some</p> <p>4 proportion of this that relates to the foreign</p> <p>5 subsidiaries, and I take it there is a</p> <p>6 different regimen that might be applicable</p> <p>7 there with respect to the royalty issues; is</p> <p>8 that fair to say?</p> <p>9 THE WITNESS: That is fair. And it</p> <p>10 is also the case that part of the U.S.</p> <p>11 revenues are from radio services that are not</p> <p>12 part of what's at issue here.</p> <p>13 JUDGE WISNIEWSKI: Thank you.</p> <p>14 BY MR. JOHNSON:</p> <p>15 Q. Just to follow up on the judge's</p> <p>16 question, the music revenue lines we just</p> <p>17 looked at --</p> <p>18 A. Yes.</p> <p>19 Q. -- does that include revenue from</p> <p>20 foreign business?</p> <p>21 A. Yes.</p> <p>22 Q. Okay. Now, you say that, "Royalty</p>

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17 (Pages 6202 to 6205)

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<p>1 payments account for more than half of our 2 revenue," correct? 3 A. Yes. 4 Q. Now, is the dollar number for 5 royalty payments reflected anywhere in your 6 statement? 7 A. In my statement or in these 8 numbers? 9 Q. Or in the numbers. 10 A. Well, it largely is. A much more 11 efficient way to look at this is actually two 12 pages later in the appendix where it says -- 13 Q. Two pages after what? 14 A. Two pages after the page we're 15 currently at. So one physical page, two 16 sides. In other words, the page that's 17 titled -- well, they all have the same title, 18 but the one that shows music, consumer, TPS in 19 vertical columns. 20 Q. Where are you, sir? 21 A. If you just turn one page from 22 where we were, go forward one page. On the</p>	<p>1 my testimony. 2 Q. Okay. So where would I find the 3 number in your statement or in the exhibits to 4 your statement that represents royalty 5 payments? 6 A. What I am trying to get to here is 7 the cost of revenue line that's shown on here 8 is principally made up -- I mean, at the 9 75-plus percent level, if not 80 percent -- 10 with royalty payments. 11 Q. 80 percent -- or 75 percent of that 12 number, 81 million -- 13 A. Yes. 14 Q. -- 462 -- 15 A. Is royalty payments. 16 Q. -- is royalty payments? 17 A. Yes. 18 Q. That's your testimony? 19 A. Yes, it is. 20 Q. All right. So that's about what? 21 A. Well, it's -- 22 Q. If you just do the math, that's</p>
Page 6203	Page 6205
<p>1 back side of that page there is a table that 2 shows vertical columns: Music, consumer, TPS, 3 other. 4 And this shows the -- this is 5 where, to answer your question, the cost of 6 the content becomes clear. Because you 7 have -- for example, halfway down that page, 8 you have the \$149 million revenue figure 9 that's in my testimony. You then have the 10 cost of revenue of 60 -- 11 Q. Just so I am clear, where is that 12 \$149 million number represented? 13 A. On the page, where is it? 14 Q. Yes. 15 A. This page is two tables, one on top 16 of the other. The first is quarterly and the 17 table below it is annual. It says, "Year 18 ended December 31, 2007." 19 So if you look at the lower one, 20 the number for music of net revenue is 149, so 21 that's the same number that we were looking at 22 on the other page and that is referred to in</p>	<p>1 about what? 2 A. \$75 million, somewhere around 3 there. 4 Q. Well, 80 percent of 80 million is 5 what? 6 A. Okay. 7 Q. Four-fifths of 80 million is what? 8 Or three-quarters of 80 million is what? 60, 9 right? 10 A. How about if I just do the actual 11 math and then I will tell you -- 12 Q. Okay. 13 A. I will give you a more precise 14 answer. 15 It's going to be about 85 percent 16 of this figure is royalty payments. 17 Q. It sounds like you have a specific 18 dollar amount in your head; is that correct? 19 A. No. What I have in my head is I 20 know the line item cost of the other 21 components of cost of goods, which is customer 22 service --</p>

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18 (Pages 6206 to 6209)

Page 6206	Page 6208
<p>1 Q. All right.</p> <p>2 A. -- bandwidth and credit card fees.</p> <p>3 Q. Okay.</p> <p>4 A. And those together typically sum to</p> <p>5 around 15 percent of our total cost for these</p> <p>6 products.</p> <p>7 Q. Okay. All right. So based on</p> <p>8 that, could you give the court your best</p> <p>9 estimate in dollars of what Real Networks'</p> <p>10 royalty payments were in 2007?</p> <p>11 A. 60 to \$65 million.</p> <p>12 Q. 60 to 65?</p> <p>13 A. Yes.</p> <p>14 Q. Okay. Now, you know, because your</p> <p>15 attorney asked you, that the majority of that</p> <p>16 amount is represented by the sound recording</p> <p>17 royalties paid to the record companies, right?</p> <p>18 A. Yes.</p> <p>19 Q. Pursuant to deals that Real</p> <p>20 Networks and its predecessor made beginning in</p> <p>21 2001, 2002, correct?</p> <p>22 A. Yes.</p>	<p>1 basis?</p> <p>2 A. It's the difference -- I would</p> <p>3 characterize it as follows. We have a</p> <p>4 business that is already highly not</p> <p>5 profitable. It could well be the difference</p> <p>6 between us being on a trajectory to make the</p> <p>7 business profitable and never becoming</p> <p>8 profitable because of the basic math that I</p> <p>9 shared earlier in this testimony.</p> <p>10 Q. Mr. Sheeran, can you --</p> <p>11 A. It's one thing to look at it and</p> <p>12 say, of your total, it's a small amount. But</p> <p>13 of the profit I'm actually getting, it's a</p> <p>14 huge amount because I have so little profit to</p> <p>15 begin with for precisely the reason that</p> <p>16 you're pointing out, which is I am already</p> <p>17 paying so much to the labels.</p> <p>18 Q. Mr. Sheeran, thank you for that</p> <p>19 point, but could you answer my question,</p> <p>20 please? For the benefit of the court, could</p> <p>21 you tell us whether or not you agree with me</p> <p>22 that the difference between our proposal and</p>
Page 6207	Page 6209
<p>1 Q. All right. And you know that the</p> <p>2 rate at which you pay record companies sound</p> <p>3 recording royalties is several multiples of</p> <p>4 what you are accruing for mechanicals, right?</p> <p>5 I don't want to, on the public</p> <p>6 record, get into the specific dollar amount,</p> <p>7 but you know that it is several multiples of</p> <p>8 what you are accruing for mechanicals,</p> <p>9 correct?</p> <p>10 A. Yes.</p> <p>11 Q. All right. And you know that the</p> <p>12 rate at which you pay sound recording</p> <p>13 royalties to the record companies is several</p> <p>14 multiples of what you would have to pay if the</p> <p>15 court adopted the copyright owners' proposal</p> <p>16 of 15?</p> <p>17 A. Yes.</p> <p>18 Q. All right. Now, given that, would</p> <p>19 you agree with me -- you can do the math --</p> <p>20 that the difference between our proposal and</p> <p>21 what you are accruing right now is a</p> <p>22 seven-digit single million number on an annual</p>	<p>1 what you are already accruing is a seven-digit</p> <p>2 single million dollar number on an annual</p> <p>3 basis? Do the math.</p> <p>4 A. In what year? In 2010?</p> <p>5 Q. Well, let's take your 2007 number</p> <p>6 and work from there. You said that the total</p> <p>7 royalties were between 60 and 65 million.</p> <p>8 You've already told us that the royalties on</p> <p>9 sound recordings that you're paying to the</p> <p>10 record companies is several multiples of what</p> <p>11 you are accruing for mechanicals and what you</p> <p>12 would have to pay in mechanicals if the court</p> <p>13 adopts our proposal.</p> <p>14 So I am now asking you, given</p> <p>15 everything you've just said, isn't it true</p> <p>16 that the difference between our proposal and</p> <p>17 what you are already accruing is a single</p> <p>18 million digit number?</p> <p>19 A. It's close -- it could be close to</p> <p>20 10, actually.</p> <p>21 Q. Could be as high as 10?</p> <p>22 A. In '07 alone. But that's not the</p>

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19 (Pages 6210 to 6213)

Page 6210	Page 6212
1 way we look at our business.	1 A. No.
2 Q. Well, I am just asking you, based	2 Q. Sometime in 2007?
3 on the numbers we know about that you have	3 A. I believe it was sometime in 2007.
4 given us in your testimony here, you're saying	4 Q. Now, is it your testimony that that
5 it could be as high as 10, right?	5 accrual number consists of both accruing for
6 A. For a year that's already in the	6 mechanicals as well as performance?
7 past.	7 A. Yes.
8 Q. Correct. Now, it's your testimony,	8 Q. All right. Now, you sound like
9 therefore, that a decision by this court that	9 you're familiar with the ASCAP decision of
10 could cost you, using '07 numbers, as much as	10 Judge Conner in the Southern District of New
11 10 million in addition to what you're already	11 York, right?
12 accruing, in a business that had net revenue	12 A. Yes.
13 of \$567 million in 2007, is going to break the	13 Q. In fact, you testified in that
14 bank; that's your testimony?	14 case, right?
15 A. Yes, it is.	15 A. Yes, I did.
16 Q. Let's talk about what you're	16 Q. And are you aware of the summary
17 accruing.	17 judgment decision that Judge Conner reached
18 A. Can I explain why?	18 about a year ago regarding performance
19 Q. You said in your written	19 royalties, the decision a year ago -- not the
20 statement -- I'm sorry?	20 decision recently, but the decision a year
21 A. Can I explain why?	21 ago?
22 Q. That's what redirect is for. Thank	22 A. I'm not -- I'm not particularly
Page 6211	Page 6213
1 you.	1 informed about that, no.
2 You said in your written direct	2 Q. Were you aware that Judge Conner a
3 statement that you are accruing between 8 and	3 year ago determined that the downloading of
4 10 percent of revenue, right? In your written	4 music does not constitute a public
5 statement --	5 performance?
6 A. Yes.	6 A. I think I was aware of that, yes.
7 Q. -- you said between 8 and	7 Q. Do you know whether any adjustment
8 10 percent. Now, this morning -- or this	8 was made to the accrual Real Networks is
9 afternoon you said that as of last year you	9 making based upon that decision?
10 were accruing at a rate of 10 percent.	10 A. I don't know.
11 A. Yes.	11 Q. But you did tell us that sometime
12 Q. Were you involved in that decision?	12 within the last year the accrual went up to
13 A. No.	13 10 percent, right?
14 Q. Who made that decision?	14 A. From 9-1/2.
15 A. I believe -- I don't know who made	15 Q. And just to be clear, 10 percent,
16 the decision. I suspect it would be somebody	16 the amount you're accruing, is about
17 in our finance department, conferring with our	17 4 percentage points greater than the proposal
18 legal department, because our legal department	18 you're making to songwriters in this
19 is the one that's closest to the likely	19 proceeding, right?
20 outcome of proceedings like this.	20 A. Yes.
21 Q. Do you know when the decision to go	21 Q. Now, you said in your written
22 to 10 was made?	22 statement that of this 8 to 10 percent, that

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20 (Pages 6214 to 6217)

Page 6214	Page 6216
<p>1 it covers total -- I'm at paragraph 16 now, 2 page 6 -- "As a general matter, we have been 3 accruing between 8 to 10 percent of 4 subscription revenue to cover total royalty 5 payments to publishers; that is, mechanical 6 payments and public performance payments for 7 these services. Based on information 8 available to me, in the ordinary course of my 9 business activities, I believe this is a 10 common accrual practice for other similar 11 music services." 12 Now -- do you know, by the way, 13 Mr. Allen McGlade -- 14 A. No, I don't. 15 Q. -- MusicNet? 16 Did anybody tell you in this 17 proceeding that MusicNet is accruing at a rate 18 of 12 percent? 19 A. I think I may have heard that, yes. 20 Q. Did you hear that in connection 21 with this proceeding or in the ordinary course 22 of business?</p>	<p>1 CHIEF JUDGE SLEDGE: Sustained. 2 BY MR. JOHNSON: 3 Q. Do you know whether that statement 4 is consistent with accounting practices? 5 A. No, I don't. 6 Q. All right. Can you look, please, 7 at Exhibit 280 again? Page 17. Now, if you 8 look at page 17 under the heading, "Music 9 publishing royalty rates for music 10 subscription services offered through Real 11 Networks and Rhapsody America are not yet 12 fully established. A determination of high 13 royalty rates could negatively impact our 14 operating results." 15 Do you see that? 16 A. Yes, I do. 17 Q. Now, that refers, at least in part, 18 to this proceeding and the mechanical royalty 19 rates to be established in this proceeding, 20 correct? 21 A. Correct. 22 Q. All right. And if you look down</p>
Page 6215	Page 6217
<p>1 A. I honestly don't remember. 2 Q. Okay. 3 A. I've heard that number before. I'm 4 in a lot of meetings. 5 Q. Now, you say at paragraph 16, 6 page 7, "We adopt accrual rates as a very 7 conservative estimate that would likely be 8 much higher than the amounts actually needed, 9 preparing for the worst-case scenario." 10 Now, did you consult an accountant 11 before you made that statement, or an auditor? 12 A. Yes. 13 Q. Is it your understanding that 14 accounting practices require you, when you set 15 aside money for an accrual, to set aside for 16 the worst-case scenario? 17 A. I'm not an accountant, so I 18 wouldn't -- 19 Q. A worst-case scenario in a lawsuit 20 could be a very big number, right? 21 MR. LAGUARDA: Objection, Your 22 Honor.</p>	<p>1 toward the bottom of that paragraph, second to 2 last sentence, you will see, "If the rates 3 agreed to or determined by a CRB or by 4 Congress are higher than we expect, the 5 increased expense could negatively impact our 6 operating results." 7 So would you agree with me that, in 8 that sentence, you are warning stockholders 9 and investors that the judges could determine 10 a rate higher than what Real Networks 11 expected, right? 12 A. Yes. 13 Q. You're warning investors of that 14 possibility, right? 15 A. Yes. 16 Q. Okay. Is there anything in there 17 that alerts investors that you are accruing 18 for a worst-case scenario? 19 A. It only talks about the scenario 20 that we expect. 21 Q. Could you look at page 33, please? 22 Down at the bottom of page 33 you will see a</p>

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21 (Pages 6218 to 6221)

Page 6218	Page 6220
1 reference to music publishing rights and music	1 opposite --
2 royalty accruals. Do you see that?	2 A. We have been on conference calls
3 A. Yes.	3 together.
4 Q. And that's a reference to the 8 to	4 Q. Can I finish my statement -- can I
5 10 percent number that you have referred to,	5 finish my question?
6 correct? That's what you're talking about	6 If I represented to you that
7 there?	7 Mr. Eisenberg sat in that chair and testified
8 A. Yes.	8 to the exact opposite, that under current
9 Q. When I say "you," I mean the	9 market conditions, he could not pass it
10 company, right?	10 through, would that change your testimony?
11 A. Yes.	11 A. No, it would not.
12 Q. Now, if you look at the very last	12 Q. You talk about, in paragraphs 10
13 sentence of that paragraph, you will see it	13 and 11, the fact that you would not be able to
14 says, "While we base our estimates on	14 pass on extra costs to the consumer for three
15 historical experience and on various other	15 reasons. Do you see that?
16 assumptions that management believes to be	16 A. Yes.
17 reasonable" -- right?	17 Q. All right. Now, the mechanical
18 A. Yes.	18 rate, you know, went up from 7.55 to 8
19 Q. All right. Now, is there anything	19 beginning in 2002, right? Do you know that?
20 in this paragraph that tells investors that	20 A. Yes, I do.
21 you are accruing for a worst-case scenario?	21 Q. And do you know that it went up to
22 A. No.	22 8-1/2 percent beginning in 2004?
Page 6219	Page 6221
1 Q. Let me go back to your statement,	1 MR. LAGUARDA: Objection.
2 please, paragraph 10. Paragraph 10 reads, "I	2 CHIEF JUDGE SLEDGE: Yes, sir?
3 expect that Real and other digital music	3 MR. LAGUARDA: I believe there is
4 providers would ultimately bear the full cost	4 an error in the question.
5 of this or any increase in the mechanical	5 JUDGE ROBERTS: What's the error,
6 royalty rate. Although we often sublicense	6 Mr. Laguarda?
7 work from labels rather than license directly	7 MR. LAGUARDA: I don't believe that
8 from the publishers, based on my experience	8 the mechanical rate has been a percentage.
9 with labels and their ability to extract	9 CHIEF JUDGE SLEDGE: Mechanical
10 higher rates and minimum fees from us, I am	10 rate --
11 very confident that they would pass through	11 MR. LAGUARDA: I don't believe the
12 any increase in the mechanical royalty rate."	12 mechanical rate has been a percentage.
13 Do you see that?	13 Mr. Johnson has asked repeatedly about
14 A. Yes.	14 percentage of mechanical rates.
15 Q. Do you stand by that statement?	15 MR. JOHNSON: I'm sorry. I
16 A. I do.	16 misspoke. All right.
17 Q. Do you know Mr. Mark Eisenberg of	17 BY MR. JOHNSON:
18 Sony BMG?	18 Q. It went up to [sic] 7.55 to 8 cents
19 A. I just met him today as he was	19 beginning in 2002. Do you know that?
20 walking out the door.	20 A. I know that it's risen. I'm not
21 Q. If I told you that Mr. Eisenberg,	21 familiar with the specifics.
22 just before you, testified the exact	22 Q. Well, you know it has risen several

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22 (Pages 6222 to 6225)

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<p>1 times in the last six years, correct?</p> <p>2 A. Yes.</p> <p>3 Q. All right. Now, you tell us in</p> <p>4 paragraph 11 that, "We, in turn, would not be</p> <p>5 able to pass on the extra costs to the</p> <p>6 consumer for three reasons," and then you go</p> <p>7 through the reasons.</p> <p>8 Now, Real Networks, in fact, raised</p> <p>9 its price for Rhapsody Unlimited from 9.99 per</p> <p>10 month to 12.99 per month in April 2007,</p> <p>11 correct?</p> <p>12 A. That's right.</p> <p>13 Q. And you raised your monthly</p> <p>14 subscription fee for Rhapsody to Go to 14.99,</p> <p>15 correct?</p> <p>16 A. No, that's not correct. It's</p> <p>17 always been 14.99.</p> <p>18 Q. How long has it been 14.99?</p> <p>19 A. Since we launched the product three</p> <p>20 years ago.</p> <p>21 Q. Okay. But you've raised it 30</p> <p>22 percent for Rhapsody Unlimited in April 2007,</p>	<p>1 less going up, we would have an extremely ugly</p> <p>2 download business.</p> <p>3 In the case of subscriptions, what</p> <p>4 I was specifically talking to was a desire to</p> <p>5 lower the price, if we can get our content</p> <p>6 cost down, such that carriers could then</p> <p>7 bundle it and we could go from a total market</p> <p>8 of under a couple million subscribers, which</p> <p>9 is where we are today with subscriptions, to</p> <p>10 having many tens of millions of subscribers.</p> <p>11 It's not one circumstance. If our</p> <p>12 costs came down, that we could then pass that</p> <p>13 on and grow the market.</p> <p>14 Q. Well, it's also true, Mr. Sheeran,</p> <p>15 that you are charging a price for a service</p> <p>16 that, in many circumstances, customers don't</p> <p>17 take advantage of; isn't that right?</p> <p>18 A. I would not characterize it that</p> <p>19 way.</p> <p>20 Q. Well, let's look at the decision of</p> <p>21 the performance rate court, Copyright Owners'</p> <p>22 285 for identification.</p>
Page 6223	Page 6225
<p>1 correct?</p> <p>2 A. Yes, that is correct.</p> <p>3 Q. All right.</p> <p>4 A. And those two are related points.</p> <p>5 Q. Now, you also said to us today --</p> <p>6 CHIEF JUDGE SLEDGE: Speak up.</p> <p>7 BY MR. JOHNSON:</p> <p>8 Q. -- that you are unable to lower</p> <p>9 price; is that your testimony? You want a</p> <p>10 discount, but you're not able to.</p> <p>11 A. I believe my testimony was we</p> <p>12 discuss all the time whether market forces are</p> <p>13 going to force us to lower price. We have</p> <p>14 chosen not to thus far on downloads.</p> <p>15 Q. Is it your testimony that you</p> <p>16 couldn't afford to lower your price?</p> <p>17 A. It is my testimony that -- let's</p> <p>18 separate downloads from subscriptions. In the</p> <p>19 case of downloads, we already have a business</p> <p>20 that has a very, very low margin. And if we</p> <p>21 lowered our retail price in an environment</p> <p>22 where our costs were not also going down, much</p>	<p>1 MR. JOHNSON: May I approach, Your</p> <p>2 Honor?</p> <p>3 CHIEF JUDGE SLEDGE: Yes.</p> <p>4 BY MR. JOHNSON:</p> <p>5 Q. Mr. Sheeran, do you have</p> <p>6 Exhibit 285 in front of you?</p> <p>7 A. Yes, I do.</p> <p>8 Q. What is Exhibit 285?</p> <p>9 A. It is the opinion in the ASCAP</p> <p>10 case.</p> <p>11 Q. And you testified in this case,</p> <p>12 correct?</p> <p>13 A. Yes, I did.</p> <p>14 Q. And did you read this opinion?</p> <p>15 A. I have read most of this opinion,</p> <p>16 not all of it.</p> <p>17 Q. And you know that your testimony,</p> <p>18 in part, forms the basis for some of the</p> <p>19 judge's findings in this decision, right?</p> <p>20 A. I know my testimony is quoted.</p> <p>21 Whether it forms the basis of his opinion, you</p> <p>22 would have to ask him.</p>

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23 (Pages 6226 to 6229)

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<p>1 Q. With regard to Real Networks'</p> <p>2 performance rights, what was the bottom line</p> <p>3 result here for your company?</p> <p>4 A. The bottom line result was that we</p> <p>5 will need -- if this is maintained as is, is</p> <p>6 that we will need to pay on all of our music</p> <p>7 business, as well as our games and video</p> <p>8 businesses, at the rate of about 2-1/2 percent</p> <p>9 to ASCAP.</p> <p>10 Q. And where was it before?</p> <p>11 A. I don't recall the answer to that.</p> <p>12 Q. Does 1.6 sound about right?</p> <p>13 A. Well -- that sounds about right,</p> <p>14 applied to our music business.</p> <p>15 Q. Okay. Would you look at page 42 --</p> <p>16 actually, page 41. If you look at page 41 to</p> <p>17 42, there is a description of the service your</p> <p>18 company provides, Rhapsody, right?</p> <p>19 A. Yes.</p> <p>20 MR. JOHNSON: I offer 285 in</p> <p>21 evidence, Your Honor. This is, by the way, a</p> <p>22 redacted version -- a redacted public version</p>	<p>1 otherwise voluminous document. It's a public</p> <p>2 document. I just don't see any reason to</p> <p>3 overburden the record with an entire document</p> <p>4 that's otherwise publicly available.</p> <p>5 Mr. Johnson is free to question the</p> <p>6 witness about the document.</p> <p>7 MR. JOHNSON: Your Honor, it's a</p> <p>8 public document. I'm not sure I see the harm</p> <p>9 or the prejudice in admitting the entire</p> <p>10 document --</p> <p>11 CHIEF JUDGE SLEDGE: Do you see any</p> <p>12 reason? I'm not worried about why not to let</p> <p>13 it in. I'm wondering why to let it in.</p> <p>14 MR. JOHNSON: Well, specifically</p> <p>15 for paragraphs 152 and 153, Judge. If -- if</p> <p>16 we are to redact the remaining portions,</p> <p>17 that's fine with me. But the reason for my</p> <p>18 offer is paragraphs 152, 153.</p> <p>19 Part of my problem here is that</p> <p>20 Mr. Sheeran's testimony in this case is</p> <p>21 confidential, and so I can't use it. But this</p> <p>22 is a public account of his testimony, and what</p>
Page 6227	Page 6229
<p>1 of the opinion. The record should reflect</p> <p>2 that.</p> <p>3 CHIEF JUDGE SLEDGE: What's the</p> <p>4 purpose of it being offered?</p> <p>5 MR. JOHNSON: I want to point out</p> <p>6 to the witness and put in evidence the</p> <p>7 findings of the court with regard to the</p> <p>8 subscription price that Rhapsody charges,</p> <p>9 which is referred to at page 42 of this, which</p> <p>10 is based on his testimony.</p> <p>11 CHIEF JUDGE SLEDGE: Are you</p> <p>12 talking about the paragraph 153?</p> <p>13 MR. JOHNSON: 152 and 153, Your</p> <p>14 Honor. And I am going to ask him whether</p> <p>15 those findings are consistent with the</p> <p>16 testimony he gave in that case.</p> <p>17 CHIEF JUDGE SLEDGE: Any response</p> <p>18 to the offer?</p> <p>19 MR. LAGUARDA: Your Honor, I would</p> <p>20 object only in that it's consistent with the</p> <p>21 rules that require separation and designation</p> <p>22 of the relevant portion of an exhibit from an</p>	<p>1 I intend to do is ask him whether the findings</p> <p>2 of the court here are consistent with the</p> <p>3 testimony he gave, which I believe is relevant</p> <p>4 to this proceeding.</p> <p>5 CHIEF JUDGE SLEDGE: Sustain the</p> <p>6 objection.</p> <p>7 BY MR. JOHNSON:</p> <p>8 Q. Mr. Sheeran, without offering the</p> <p>9 document into evidence, can you look at</p> <p>10 paragraphs 152, 153, please?</p> <p>11 A. Okay.</p> <p>12 Q. You see they contain citations to</p> <p>13 testimony you gave, correct?</p> <p>14 A. Yes.</p> <p>15 Q. And the first paragraph reads, "A</p> <p>16 Rhapsody subscriber can play as much or as</p> <p>17 little music as he or she wants. Regardless</p> <p>18 of the actual amount of music played, however,</p> <p>19 the Rhapsody subscriber must still pay the</p> <p>20 full subscription fee. If the subscriber</p> <p>21 continues to pay the subscription fee, then</p> <p>22 neither the amount nor the type of music</p>

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24 (Pages 6230 to 6233)

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1 actually played by the subscriber affects the	1 evidence.
2 amount of revenue received by Real Networks."	2 CHIEF JUDGE SLEDGE: Any objection
3 The next paragraph. "There is a	3 to 288?
4 percentage of Rhapsody to Go subscribers who	4 MR. LAGUARDA: No, Your Honor.
5 do not take advantage of the portability	5 CHIEF JUDGE SLEDGE: Without
6 feature that is offered as part of the	6 objection, it's admitted.
7 subscription. Those individuals are, in	7 (Copyright Owners' Trial Exhibit
8 essence, paying an additional \$2 (over and	8 No. 288 was received into evidence.)
9 above the Rhapsody Unlimited subscription fee)	9 BY MR. JOHNSON:
10 for a portability feature they do not use.	10 Q. Mr. Sheeran, could you look at the
11 Real Networks, however, does not refund any	11 last full paragraph on the page that begins
12 portion of the fee for subscribers who do not	12 with, "For the first quarter of 2008," on the
13 use the portability feature."	13 first page?
14 My question to you, sir, without	14 A. Yes.
15 offering this document in evidence, is -- is	15 Q. All right. And it reads, "For the
16 what I just read to you consistent with the	16 first quarter of 2008, revenue grew 14 percent
17 testimony you gave in this proceeding?	17 to 147.6 million, compared with 129.5 million
18 A. In that proceeding?	18 for the first quarter of 2007," correct?
19 Q. Yes.	19 A. Yes.
20 A. That proceeding was nine months	20 Q. Is that an accurate statement?
21 ago. I don't recall. I don't have any reason	21 A. I'm sure it is, if we issued this
22 to believe that it was -- that I did not say	22 press release.
Page 6231	Page 6233
1 this, if it's in here. And I would also be	1 Q. And if you look five lines down,
2 happy to explain this, if you're interested in	2 you will also see that for the first quarter
3 this.	3 of 2008 there was a 12 percent increase in
4 Q. Mr. Sheeran, you had an earnings	4 music revenue to 38.1. Do you see that?
5 release last week, correct?	5 A. Yes, I do.
6 A. Yes.	6 Q. And if you look toward the top of
7 Q. For the first quarter 2008?	7 the text here, the very first paragraph, you
8 A. Yes.	8 will see a statement there from Rob Glaser,
9 Q. And it is the case that for 2008,	9 CEO of Real Networks, "Our results exceeded
10 first quarter, revenue grew -- this is for the	10 our expectations across every major business."
11 overall business. Revenue grew 14 percent to	11 Do you see that?
12 147.6 million, compared with 129.5 million for	12 A. Yes.
13 the first quarter of 2007; is that correct?	13 Q. All right. And turn to the next
14 A. I don't know. I don't have any	14 page, please, the paragraph that begins with,
15 documents in front of me.	15 "As of March 31, '08." Do you see that?
16 Q. Let me show you what I have marked	16 A. Yes.
17 as Exhibit 288 for identification.	17 Q. "As of March 31, 2008, Real had
18 Do you recognize Copyright Owners'	18 approximately 539.6 million in unrestricted
19 Exhibit 288 as an earnings release announcing	19 cash."
20 first quarter 2008 results for Real Networks?	20 Do you see that?
21 A. Yes.	21 A. Yes.
22 MR. JOHNSON: I offer it in	22 Q. "Cash equivalents and short-term

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<p>1 investments, and 100 million of convertible 2 debt." 3 Do you see that? 4 A. Yes. 5 MR. JOHNSON: I have no further 6 questions. 7 CHIEF JUDGE SLEDGE: Any redirect? 8 MR. LAGUARDA: One question, Your 9 Honor. 10 CHIEF JUDGE SLEDGE: All right. 11 REDIRECT EXAMINATION 12 BY MR. LAGUARDA: 13 Q. Mr. Sheeran, I believe Mr. Johnson 14 asked you a question -- I wanted to give you 15 an opportunity to respond with respect to why 16 additional royalty payments that are being 17 sought by the copyright owners would make a 18 difference to your business, given that you 19 are accruing already for royalty payments. 20 A. This business is a challenging one 21 that requires us to get to a much larger 22 scale, and with our current margin structure,</p>	<p>1 message has been repeated in your testimony 2 frequently, and it's curious. It sounds like 3 you think you're testifying before Congress at 4 a hearing as to what royalties ought to be 5 allowed for use of copyright content. 6 Why should we consider what you pay 7 royalties for other rights than the rights 8 in -- which we're addressing in this trial? 9 THE WITNESS: Well, the -- because, 10 Your Honor, the incremental benefit that 11 the -- we don't see any incremental benefit 12 that the consumer gets if they -- by paying 13 the additional fee. In other words, if we're 14 paying copyright holders, through the 15 performing rights organizations, for the 16 ability to provide a consumer the experience 17 of an on-demand music stream, if we then need 18 to then pay them again -- if there is some 19 other license we then need to pay them for, 20 what was our first payment for? Because there 21 really is nothing we're allowed to deliver to 22 the consumer.</p>
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<p>1 that is challenging, but we see a path. I've 2 talked today about some of the ways we intend 3 to achieve that, such as through our bundling 4 strategy with carriers. 5 With -- if we needed to adopt the 6 rates proposed by the copyright owners, that 7 would make it -- it's difficult for me to know 8 today how we would ever get the business to be 9 break-even either based on our current product 10 offerings or based on getting the carrier 11 bundle strategy to work because of both the 12 absolute costs and level of where the minima 13 are that they are looking for. 14 So it would really lead us to ask 15 very hard questions about whether this is -- 16 whether the way that we're approaching this 17 business today is the right way to look at it, 18 the right way to be investing in it. 19 MR. LAGUARDA: No further 20 questions. 21 CHIEF JUDGE SLEDGE: Mr. Sheeran, 22 look at paragraph 20 of your statement. This</p>	<p>1 CHIEF JUDGE SLEDGE: Isn't that an 2 argument you make to Congress when they create 3 two separate rights? That argument is gone. 4 Congress has already created those two 5 separate rights. Why are you making it here? 6 THE WITNESS: All I can -- the only 7 answer I can give you, Your Honor, is that of 8 looking at this from the businessperson's 9 perspective and the consumer perspective. I 10 can't tell you whether our attorneys, who were 11 trying to influence legislation, would have a 12 different answer. 13 When I look at this as a person 14 trying to construct a service, I am just not 15 even familiar with ever having to go and get 16 the permission to do one thing in two 17 different ways from the same person. 18 CHIEF JUDGE SLEDGE: You're not 19 very familiar with regulatory -- 20 THE WITNESS: That may well be 21 true. 22 CHIEF JUDGE SLEDGE: It just seems</p>

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<p>1 like you're wasting your time and our time to</p> <p>2 argue something that is a policy decision made</p> <p>3 by Congress. They have created the rights</p> <p>4 that you're complaining about. We have no</p> <p>5 ability to say, well, it's a burden on you,</p> <p>6 therefore, we're going to eliminate the rights</p> <p>7 that Congress has created, and you don't have</p> <p>8 to pay performance rights because that's too</p> <p>9 much for you to have to pay.</p> <p>10 THE WITNESS: Well, first, I</p> <p>11 apologize if it seems like we're wasting your</p> <p>12 time. That's not at all the intent.</p> <p>13 The analogy that I -- the reason</p> <p>14 this still seems to us to be inappropriate,</p> <p>15 even if Congress has taken this position, is</p> <p>16 that thus -- historically, the use of</p> <p>17 mechanical licenses, as granted by Congress,</p> <p>18 has always been, to my knowledge, to grant</p> <p>19 some degree of ability to make a copy that</p> <p>20 ultimately confers a benefit and, in the case</p> <p>21 of a consumer, some degree of ownership or</p> <p>22 right to act with a given piece of music. And</p>	<p>1 been in our laws for a century?</p> <p>2 THE WITNESS: While I'm not a</p> <p>3 lawyer, I don't know whether, in all or even</p> <p>4 most of those cases, the same person was also</p> <p>5 paying a public performance fee for the same</p> <p>6 experience.</p> <p>7 CHIEF JUDGE SLEDGE: We're not</p> <p>8 setting public performance fees.</p> <p>9 THE WITNESS: Well, I understand</p> <p>10 your point, and I don't want to waste your</p> <p>11 time by trying to express myself any other way</p> <p>12 on this.</p> <p>13 CHIEF JUDGE SLEDGE: Any other</p> <p>14 questions?</p> <p>15 JUDGE ROBERTS: Yes, I have one.</p> <p>16 If you would turn to page 2, Mr. Sheeran, of</p> <p>17 your testimony, please. I am looking at</p> <p>18 paragraph 6, toward the bottom of paragraph 6.</p> <p>19 And in paragraph 6 you're talking about the</p> <p>20 costs that you incur for providing the music</p> <p>21 products that you do. And, in particular, I</p> <p>22 am looking at the sentence that begins with</p>
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<p>1 absent this coming along, with what we need to</p> <p>2 pay the PROs, there really is no -- the</p> <p>3 consumer is not allowed to get the stream at</p> <p>4 all.</p> <p>5 So I apologize if it seems like</p> <p>6 we're wasting everyone's time. We don't</p> <p>7 understand the logic of it, and I don't know</p> <p>8 whether Congress fully understood, in taking</p> <p>9 that approach, that there was actually nothing</p> <p>10 one could do with one but not the other. I</p> <p>11 don't know what else to tell you.</p> <p>12 CHIEF JUDGE SLEDGE: Are you</p> <p>13 familiar with how long users of copyright</p> <p>14 material have had to pay mechanical rates?</p> <p>15 THE WITNESS: A very long time.</p> <p>16 CHIEF JUDGE SLEDGE: Almost a</p> <p>17 century.</p> <p>18 THE WITNESS: Yes.</p> <p>19 CHIEF JUDGE SLEDGE: Over a</p> <p>20 century. And that's what you're complaining</p> <p>21 about, is that you're having to pay something</p> <p>22 that's been -- that's in our Constitution and</p>	<p>1 the word "second." Do you see that?</p> <p>2 THE WITNESS: Yes.</p> <p>3 JUDGE ROBERTS: It says, "Second,</p> <p>4 we face high legal and technical costs in</p> <p>5 order to clear licenses, obtain physical</p> <p>6 copies of music, prepare music for delivery,</p> <p>7 store it, and deliver it to end users."</p> <p>8 And my first question to you is</p> <p>9 that with respect to the list of items that</p> <p>10 you provide here, which is to clear licenses,</p> <p>11 obtain physical copies, prepare the music for</p> <p>12 delivery, store it and deliver it to end</p> <p>13 users, with the exception of clearing</p> <p>14 licenses, are the rest of those all your</p> <p>15 technical costs only, such that the only legal</p> <p>16 cost you refer to here is clearing licenses?</p> <p>17 THE WITNESS: I believe that's</p> <p>18 right.</p> <p>19 JUDGE ROBERTS: Okay. Given that,</p> <p>20 could you please explain to us what your high</p> <p>21 legal costs are with respect to clearing</p> <p>22 licenses?</p>

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<p>1 THE WITNESS: Sure. We employ -- 2 in-house, we employ three 100-percent 3 dedicated attorneys who are very capable and 4 not cheap. We then have an additional, I 5 would estimate, four or more, maybe five, 6 full-time equivalent attorneys in house that 7 work on this. We have consultants who help 8 us -- external consultants who help us in 9 negotiating with the labels. And then we have 10 outside law firms that help us both in our 11 contracts and in proceedings like this. 12 And the aggregate of all of that is 13 quite -- is a lot of money. 14 JUDGE ROBERTS: How would a higher 15 mechanical royalty fee impact these legal 16 costs? Would it require you to hire more 17 attorneys, hire more licensing people? I'm 18 not sure that I understand how the legal fees 19 that you have have a bearing on what the 20 mechanical rate is. 21 THE WITNESS: This part of this 22 paragraph was intended only to convey why this</p>	<p>1 only to show why what may appear to be a very 2 small percentage increase on the mechanicals 3 is a very large impact to our overall profit 4 margin, because these are thin-profit 5 businesses. 6 JUDGE ROBERTS: Thank you for the 7 clarification. 8 JUDGE WISNIEWSKI: Just one 9 question, Mr. Sheeran. I'm not sure the 10 record is entirely clear on this. I am going 11 to try and ask it carefully. How much of the 12 10 percent accrual rate that you were talking 13 about earlier is being accrued to cover the 14 cost of the domestic mechanical royalties at 15 issue in this matter? 16 THE WITNESS: We intentionally used 17 10 percent as an all-in number because we had, 18 until quite recently, variables in both the 19 outcome of this and the outcome of the ASCAP 20 trial. And so I don't think there is a 21 specific number, but our assumption had, I 22 believe, been that they would land in the same</p>
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<p>1 is a difficult -- why this margin already has 2 difficult gross margins. You're correct that 3 this would not raise our legal costs, unless 4 we didn't finish this proceeding pretty soon. 5 But I was explaining why -- it helps explain 6 why the gross margins that I talked about at 7 the very beginning of my testimony today are 8 as low as they are. We have all these costs 9 on the gross margin side, and then additional 10 costs on our operating costs [sic]. 11 So it was merely intended to only 12 explain the tables that appear in the 13 appendix. 14 JUDGE ROBERTS: Okay. And that's 15 the same for your technical costs -- 16 THE WITNESS: Yes, that's right. 17 JUDGE ROBERTS: -- that these are 18 your costs, and they're very high, but the -- 19 what the royalty fee was for mechanicals 20 doesn't affect those particular high technical 21 costs. 22 THE WITNESS: Yes, it was intended</p>	<p>1 neighborhood, so roughly half each, but I 2 don't think there was ever a specific, you 3 know, it's 5 percent for this and 5 percent 4 for that. But we didn't think it was going to 5 be 90/10. 6 JUDGE WISNIEWSKI: You didn't have 7 any particular expectation as to how that 8 would split out. 9 THE WITNESS: Well, we did, and -- 10 JUDGE WISNIEWSKI: What was it? 11 THE WITNESS: We thought the 12 aggregate of the two would not be more than 13 10 percent, which is why we were accruing at 14 that rate. And the ASCAP ruling, as we 15 discussed earlier, as it applies to our music 16 business, came in a little higher than 17 expected. The proposal from the copyright 18 holders came in much, much higher than 19 expected. 20 JUDGE WISNIEWSKI: So are you 21 trying to say you were expecting more for the 22 former as opposed to the latter? Is that what</p>

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<p>1 you're telling me?</p> <p>2 THE WITNESS: We expected the two</p> <p>3 together to come in around 10, and we didn't</p> <p>4 expect either one to predominate. Whether one</p> <p>5 came in at 6 and the other came in at 4, I</p> <p>6 don't think we got into that specific of a</p> <p>7 forecast.</p> <p>8 JUDGE WISNIEWSKI: Thank you.</p> <p>9 CHIEF JUDGE SLEDGE: Any other</p> <p>10 questions?</p> <p>11 JUDGE ROBERTS: I do have one more.</p> <p>12 And I assume, Mr. Sheeran, that in that</p> <p>13 context you're mostly concerned with what the</p> <p>14 total cost of royalties are. You don't really</p> <p>15 care individually whether the split -- whether</p> <p>16 the copyright owners get more or the record</p> <p>17 companies get more; you're mostly concerned</p> <p>18 with the bottom line number, I presume.</p> <p>19 THE WITNESS: In terms of what I</p> <p>20 care about, what you're saying is accurate.</p> <p>21 Of course, because one of them we have --</p> <p>22 because we have essentially no ability -- no</p>	<p>1 very much, of course, about where this process</p> <p>2 is going to end. But once it ends, at least</p> <p>3 then you can build a long-term business plan</p> <p>4 around it because you know the answer. Or you</p> <p>5 can choose to not be in the business, you</p> <p>6 know.</p> <p>7 CHIEF JUDGE SLEDGE: That answer</p> <p>8 puzzles me further. How can that be true,</p> <p>9 given the fact that no one uses the mechanical</p> <p>10 royalty rates that are established through</p> <p>11 this proceeding or prior proceedings?</p> <p>12 THE WITNESS: Do you mean today no</p> <p>13 one uses them?</p> <p>14 CHIEF JUDGE SLEDGE: Correct.</p> <p>15 THE WITNESS: Well, because we've</p> <p>16 made an assumption about where they would</p> <p>17 land, which is in our accruals.</p> <p>18 CHIEF JUDGE SLEDGE: The industry</p> <p>19 has never used them, have they?</p> <p>20 THE WITNESS: We have been accruing</p> <p>21 since the beginning of the -- of entering this</p> <p>22 business, knowing that it was coming</p>
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<p>1 leverage over the labels to get them to lower</p> <p>2 their rates, we care very, very deeply about</p> <p>3 this proceeding because we're extremely</p> <p>4 confident that we cannot go back to them and</p> <p>5 say, oh, this came in higher; therefore, you</p> <p>6 need to make us whole by lowering your rates.</p> <p>7 CHIEF JUDGE SLEDGE: You just</p> <p>8 raised something that I have big question</p> <p>9 marks in my notes that you said earlier. Why</p> <p>10 do the labels have more disparate bargaining</p> <p>11 power with you than the publishers do? You</p> <p>12 have to have both, don't you?</p> <p>13 THE WITNESS: We have to have both,</p> <p>14 but there is no statutory rate with the</p> <p>15 labels, which means that we never get to</p> <p>16 completion. Every year we have to go back and</p> <p>17 see what the rate is going to be for the next</p> <p>18 year. And any one of them can cripple us by</p> <p>19 just denying us their license.</p> <p>20 JUDGE ROBERTS: And you don't have</p> <p>21 to worry about that on the mechanical side?</p> <p>22 THE WITNESS: Well, we're worried</p>	<p>1 eventually.</p> <p>2 CHIEF JUDGE SLEDGE: All of your</p> <p>3 use of mechanical content had been through</p> <p>4 voluntary agreements. You have never used a</p> <p>5 compulsory license for any mechanical right.</p> <p>6 THE WITNESS: In the case of</p> <p>7 downloads, the labels have taken care of that</p> <p>8 and included what we owe for mechanicals in</p> <p>9 what they charge us.</p> <p>10 In the case of our subscription</p> <p>11 services, that we have simply been accruing</p> <p>12 for, awaiting the outcome of this proceeding.</p> <p>13 Whether the labels were taking a</p> <p>14 statutory license or not, you would have to</p> <p>15 ask them. They had represented the following</p> <p>16 includes the payment for the mechanicals.</p> <p>17 CHIEF JUDGE SLEDGE: Anything else?</p> <p>18 JUDGE ROBERTS: No.</p> <p>19 CHIEF JUDGE SLEDGE: Thank you,</p> <p>20 sir.</p> <p>21 THE WITNESS: Thank you.</p> <p>22 (Witness excused.)</p>

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Trial Testimony of Timothy Quirk

Services Designations (Blue)

Copyright Owner Designations (Yellow)

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<p>1 A. A specific demand elasticity study</p> <p>2 is one that essentially attempts to estimate,</p> <p>3 holding constant all of the things that could</p> <p>4 affect the quantity that consumers of a</p> <p>5 particular product would find important, such</p> <p>6 as the price of other products, close</p> <p>7 substitutes, the nature of their demands, the</p> <p>8 characteristics of the products, the quality</p> <p>9 of the products. It's an attempt to estimate</p> <p>10 econometrically what the response in terms of</p> <p>11 quantity demanded would be to a specific price</p> <p>12 point.</p> <p>13 It tends also to be something that</p> <p>14 one looks at in general, if one is doing it</p> <p>15 econometrically, in and around the particular</p> <p>16 market prices that are relevant. So one would</p> <p>17 be looking, for example, at the demand</p> <p>18 elasticity for a given demand curve in and</p> <p>19 around the market price.</p> <p>20 Q. And you didn't do any specific</p> <p>21 demand elasticity study for the digital music</p> <p>22 market, did you?</p>	<p>1 Q. And not for subscription, correct?</p> <p>2 A. No.</p> <p>3 MR. COHEN: No further questions,</p> <p>4 Your Honor.</p> <p>5 CHIEF JUDGE SLEDGE: We will</p> <p>6 recess, ten minutes.</p> <p>7 (Recess.)</p> <p>8 CHIEF JUDGE SLEDGE: Thank you. We</p> <p>9 will come to order. Any questions by RIAA?</p> <p>10 MR. FREEDMAN: No, Your Honor.</p> <p>11 CHIEF JUDGE SLEDGE: Any redirect?</p> <p>12 MR. LAGUARDA: No, Your Honor.</p> <p>13 CHIEF JUDGE SLEDGE: Any questions</p> <p>14 from the bench?</p> <p>15 Thank you, ma'am. You're excused.</p> <p>16 THE WITNESS: Thank you.</p> <p>17 (Witness excused.)</p> <p>18 MR. LAGUARDA: Your Honor, if I</p> <p>19 could have the court's brief indulgence while</p> <p>20 we set up for the next witness.</p> <p>21 CHIEF JUDGE SLEDGE: Mr. Laguarda?</p> <p>22 MR. LAGUARDA: Your Honor, at this</p>
Page 4584	Page 4586
<p>1 A. Of the type I just talked about,</p> <p>2 no.</p> <p>3 Q. Neither for downloads, correct?</p> <p>4 A. Of the type I just talked about,</p> <p>5 no.</p> <p>6 Q. Nor did you do a specific demand</p> <p>7 elasticity study for the subscription</p> <p>8 business, correct?</p> <p>9 A. Of the type I talked about, no.</p> <p>10 Q. And when you do a specific demand</p> <p>11 elasticity study, you generate elasticity</p> <p>12 coefficients?</p> <p>13 A. Of the type that I mentioned, if</p> <p>14 you were doing, for example, a regression</p> <p>15 analysis, you identify a point estimate or a</p> <p>16 coefficient, that's correct.</p> <p>17 Q. And you didn't do that for the</p> <p>18 digital music business, correct?</p> <p>19 A. That specific type of analysis or a</p> <p>20 specific estimation of coefficient, no.</p> <p>21 Q. Not for downloads, right?</p> <p>22 A. No.</p>	<p>1 time the Digital Media Association calls</p> <p>2 Timothy Quirk.</p> <p>3 CHIEF JUDGE SLEDGE: Mr. Quirk,</p> <p>4 please stand and raise your hand.</p> <p>5 Whereupon,</p> <p>6 TIMOTHY QUIRK,</p> <p>7 called for examination by counsel, and having</p> <p>8 been affirmed by the Chief Judge, was examined</p> <p>9 and testified as follows:</p> <p>10 CHIEF JUDGE SLEDGE: Thank you,</p> <p>11 Please be seated.</p> <p>12 DIRECT EXAMINATION</p> <p>13 BY MR. LAGUARDA:</p> <p>14 Q. Good morning. Could you please</p> <p>15 state your full name for the record.</p> <p>16 A. My name is Timothy Bruce Quirk.</p> <p>17 Q. And please speak up.</p> <p>18 A. Okay.</p> <p>19 Q. Where are you currently employed?</p> <p>20 A. I work for Rhapsody America.</p> <p>21 Q. And what is Rhapsody America?</p> <p>22 A. Rhapsody America is a joint venture</p>

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<p>1 formed last August between Real Networks and</p> <p>2 Viacom.</p> <p>3 Q. And what is your title or present</p> <p>4 position?</p> <p>5 A. My present position is vice</p> <p>6 president of music programming.</p> <p>7 Q. And what are your duties in that</p> <p>8 position?</p> <p>9 A. I oversee the team that catalogs</p> <p>10 and curates all the music within the Rhapsody</p> <p>11 subscription service.</p> <p>12 Q. Taking us back, could you tell the</p> <p>13 court where you obtained your undergraduate</p> <p>14 degree?</p> <p>15 A. I graduated from Stanford</p> <p>16 University.</p> <p>17 Q. And did you have any postgraduate</p> <p>18 education after that?</p> <p>19 A. Yes. I received a master of fine</p> <p>20 arts in dramatic writing from NYU.</p> <p>21 Q. And during that time did you become</p> <p>22 involved in the music business?</p>	<p>1 A. Yes, I was, and I am.</p> <p>2 Q. How many songs have you written?</p> <p>3 A. Between 100 and 150 over the years.</p> <p>4 Q. For your band?</p> <p>5 A. Yes, for Too Much Joy, and a side</p> <p>6 project that the guitar player and I formed</p> <p>7 around the year 2000 called Wonderlick.</p> <p>8 Q. If I could just remind you to speak</p> <p>9 up.</p> <p>10 A. Okay.</p> <p>11 Q. And did you have a publishing deal</p> <p>12 when you started out?</p> <p>13 A. Not when we started out. When we</p> <p>14 got signed to the Warner Bros. label, we got a</p> <p>15 publishing deal with -- at the time it was</p> <p>16 Virgin Music Publishing which eventually</p> <p>17 became EMI Music Publishing.</p> <p>18 Q. Did your publisher help you in any</p> <p>19 way?</p> <p>20 A. They did. They gave us a very</p> <p>21 large advance which helped us pay our rent</p> <p>22 while we were major label musicians. They</p>
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<p>1 A. Yes. I was -- I had formed a band</p> <p>2 called Too Much Joy with some friends in high</p> <p>3 school. While I was in grad school, we</p> <p>4 self-released our first album. That got -- we</p> <p>5 then got signed to an independent label in San</p> <p>6 Francisco, released our second album. That</p> <p>7 album got picked up by Warner Bros., a Warner-</p> <p>8 Music Group label called Giant.</p> <p>9 We recorded -- so Giant rereleased</p> <p>10 that album. We recorded two more records for</p> <p>11 Giant, then moved over to Discovery, which was</p> <p>12 another Time Warner label, and then released</p> <p>13 some more albums via independent labels after</p> <p>14 that.</p> <p>15 Q. How many albums?</p> <p>16 A. One, two, three, four -- seven.</p> <p>17 Q. And what did you do in the band?</p> <p>18 A. I was the -- I was the front guy.</p> <p>19 I stood in the middle and yelled.</p> <p>20 Q. Did the band sell any CDs?</p> <p>21 A. Yes, we did.</p> <p>22 Q. Were you a songwriter as well?</p>	<p>1 also contributed some promotional money mostly</p> <p>2 to help get us on the radio, again while we</p> <p>3 were on the major label.</p> <p>4 From time to time there would be</p> <p>5 licensing requests for movies, TV shows,</p> <p>6 things like that. They would deal with that.</p> <p>7 Q. Have you been a music publisher</p> <p>8 yourself?</p> <p>9 A. Yes. We -- you know, everyone in</p> <p>10 the band was a cowriter of all our songs. I</p> <p>11 was the lyricist, but we all wrote the music</p> <p>12 together. So we formed a publishing company</p> <p>13 to control that material, and then I formed a</p> <p>14 second publishing company to control the</p> <p>15 material that Wonderlick records.</p> <p>16 Q. Do you consider yourself still a</p> <p>17 songwriter today?</p> <p>18 A. Yes.</p> <p>19 Q. Are you still recording music?</p> <p>20 A. I am. I have a -- Wonderlick has a</p> <p>21 digital-only EP coming out in about a week.</p> <p>22 Q. Are you affiliated with ASCAP or</p>

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<p>1 BMI?</p> <p>2 A. I am with ASCAP.</p> <p>3 Q. Do you receive mechanical royalties</p> <p>4 still?</p> <p>5 A. I do.</p> <p>6 Q. And public performance royalties?</p> <p>7 A. I do.</p> <p>8 Q. At what point in time did you enter</p> <p>9 the real workforce?</p> <p>10 A. Well, you're assuming that being a</p> <p>11 musician is not the real workforce. But I got</p> <p>12 a 9:00 to 5:00 job in 1999. I joined a</p> <p>13 startup in San Francisco called Listen.com.</p> <p>14 Q. What were your duties at the time?</p> <p>15 A. I initially joined as the soul R&B</p> <p>16 music reviewer, and very quickly after that</p> <p>17 became managing editor, and eventually the</p> <p>18 head of the editorial department.</p> <p>19 MR. LAGUARDA: May I approach, Your</p> <p>20 Honor?</p> <p>21 BY MR. LAGUARDA:</p> <p>22 Q. Mr. Quirk, I have placed in front</p>	<p>1 exhibit that contain confidential information.</p> <p>2 And for the court's convenience, I have</p> <p>3 prepared a redaction log, if I may approach.</p> <p>4 Your Honor, the redaction log,</p> <p>5 which has been marked as DiMA Trial Exhibit 9,</p> <p>6 identifies and references three categories of</p> <p>7 information that Real Networks is requesting</p> <p>8 confidential treatment of. The first is</p> <p>9 information from the company's internal</p> <p>10 financials and P&L, the disclosure of which</p> <p>11 would cause competitive harm, information of</p> <p>12 the type that has previously been protected in</p> <p>13 this proceeding contained in limited</p> <p>14 paragraphs of the testimony, paragraphs 49 and</p> <p>15 50, and also reflected in an attachment,</p> <p>16 Exhibit E -- appendix E, which contains a</p> <p>17 company P&L.</p> <p>18 The second category, also</p> <p>19 information which has been protected</p> <p>20 previously in this proceeding in paragraphs 58</p> <p>21 and 59, refer to payments or terms of</p> <p>22 licensing agreements that are in effect</p>
Page 4592	Page 4594
<p>1 of you what has been marked for identification</p> <p>2 as DiMA Trial Exhibit No. 8. Do you have</p> <p>3 that?</p> <p>4 A. I do.</p> <p>5 Q. And do you recognize it?</p> <p>6 A. I do.</p> <p>7 Q. Can you tell the court what it is?</p> <p>8 A. It's my written testimony.</p> <p>9 Q. And those are the exhibits to your</p> <p>10 testimony?</p> <p>11 A. Yes.</p> <p>12 Q. Can you please turn to the last</p> <p>13 page of the written testimony following</p> <p>14 page 35. Is that your signature there?</p> <p>15 A. It is.</p> <p>16 Q. Are the contents of your written</p> <p>17 testimony, DiMA Trial Exhibit 8, true?</p> <p>18 A. They are.</p> <p>19 MR. LAGUARDA: Your Honor, prior to</p> <p>20 moving to admit the exhibits into evidence, I</p> <p>21 would like to move to apply the protective</p> <p>22 order to certain limited portions of the</p>	<p>1 between the company and content providers.</p> <p>2 And the third, in paragraph 42, is</p> <p>3 information relating to specific artists and</p> <p>4 specific record labels which the company is</p> <p>5 obligated to seek confidential treatment of,</p> <p>6 and the disclosure of which could affect the</p> <p>7 company's competitive standing with those</p> <p>8 content suppliers.</p> <p>9 And those reasons are explained in</p> <p>10 the confidentiality log.</p> <p>11 CHIEF JUDGE SLEDGE: Any objection</p> <p>12 to the motion?</p> <p>13 MR. JOHNSON: Well, yes, only in</p> <p>14 the sense that, Your Honor, I think this is</p> <p>15 the first time I have actually seen these.</p> <p>16 Every version of this statement that we have</p> <p>17 had up to now does not contain any redactions</p> <p>18 or indications that they would be seeking</p> <p>19 protection with respect to these. So I am</p> <p>20 looking at it right now. I was just handed</p> <p>21 this.</p> <p>22 But having said that, one comment I</p>

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<p>1 have, Your Honor, from my quick review is -- I</p> <p>2 find it a little hard to believe that the</p> <p>3 number of songs in the catalog is information</p> <p>4 that needs the protection of this court.</p> <p>5 That's at page 13.</p> <p>6 MR. LAGUARDA: If I might, we are</p> <p>7 not seeking designation -- we have not</p> <p>8 designated that for --</p> <p>9 MR. JOHNSON: You have it bracketed</p> <p>10 here.</p> <p>11 MR. LAGUARDA: I'm sorry. To be</p> <p>12 clear, when the report was prepared -- when</p> <p>13 the testimony was prepared, all of that</p> <p>14 information was considered to be confidential,</p> <p>15 but we have substantially reduced the</p> <p>16 confidentiality request and are only</p> <p>17 requesting it with respect to the information</p> <p>18 in DiMA Trial Exhibit 9 which does not refer</p> <p>19 to any of the information about the catalog</p> <p>20 size.</p> <p>21 MR. JOHNSON: Well, part of my</p> <p>22 problem, Your Honor, is the version that I</p>	<p>1 CHIEF JUDGE SLEDGE: We will come</p> <p>2 to order.</p> <p>3 The motion is denied as to</p> <p>4 paragraph 59 and granted as to all the rest.</p> <p>5 MR. LAGUARDA: Thank you, Your</p> <p>6 Honor. May I proceed?</p> <p>7 CHIEF JUDGE SLEDGE: Yes.</p> <p>8 MR. LAGUARDA: If I may, since that</p> <p>9 was for application of the protective order,</p> <p>10 for clarity in the record I would move DiMA</p> <p>11 Trial Exhibit 7 into evidence -- 8.</p> <p>12 CHIEF JUDGE SLEDGE: It's a curious</p> <p>13 way to phrase it, for clarity of the record.</p> <p>14 MR. LAGUARDA: I apologize, Your</p> <p>15 Honor. If I may --</p> <p>16 CHIEF JUDGE SLEDGE: Either you're</p> <p>17 offering the exhibit or you're not.</p> <p>18 MR. LAGUARDA: I am offering the</p> <p>19 exhibit into evidence.</p> <p>20 CHIEF JUDGE SLEDGE: Any objection</p> <p>21 to the exhibit?</p> <p>22 MR. JOHNSON: No, Your Honor.</p>
Page 4596	Page 4598
<p>1 have had up to now of the written statement</p> <p>2 does not contain any of these redactions. So</p> <p>3 I'm at a little bit of a disadvantage here.</p> <p>4 Having said that, I don't think I have any</p> <p>5 objections to the proposed redactions on this</p> <p>6 sheet.</p> <p>7 CHIEF JUDGE SLEDGE: What are the</p> <p>8 provisions of orders or rules that apply to</p> <p>9 identifying information to be redacted?</p> <p>10 MR. JOHNSON: Your Honor, I can</p> <p>11 only point out to you that with prior</p> <p>12 witnesses when I have seen a written</p> <p>13 statement, it usually does contain the</p> <p>14 redactions so that I know in advance what the</p> <p>15 protections that will be sought are. But as</p> <p>16 I've said, Your Honor, I've reviewed the</p> <p>17 redaction sheet that Mr. Laguarda handed me,</p> <p>18 and I don't think I have any objections with</p> <p>19 respect to what he proposes.</p> <p>20 CHIEF JUDGE SLEDGE: We will</p> <p>21 recess.</p> <p>22 (Recess.)</p>	<p>1 CHIEF JUDGE SLEDGE: Without</p> <p>2 objection, it's admitted.</p> <p>3 (DiMA Trial Exhibit No. 8 was</p> <p>4 received into evidence.)</p> <p>5 MR. LAGUARDA: Thank you.</p> <p>6 BY MR. LAGUARDA:</p> <p>7 Q., Mr. Quirk, if you could please</p> <p>8 describe for the court what the major benefits</p> <p>9 are of the Rhapsody service.</p> <p>10 A. Okay. The major benefits -- well,</p> <p>11 to consumers or to songwriters it's actually</p> <p>12 the same. The major benefit is that a</p> <p>13 subscription service like Rhapsody makes more</p> <p>14 people listen to more music more often.</p> <p>15 That's the main job of my team is to make sure</p> <p>16 that that's happening.</p> <p>17 There are several sort of -- there</p> <p>18 are four or five different ways that we make</p> <p>19 that happen. The first is we have -- we</p> <p>20 provide access to a massive catalog of music,</p> <p>21 so again, as a songwriter and a musician, I</p> <p>22 released several records on Warner Bros. A</p>

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<p style="text-align: right;">Page 4599</p> <p>1 few of them went out of print physically. And 2 it wasn't until this digital music revolution 3 came about that those records were able to be 4 back in print and accessible to people again. 5 So unlike in physical retail where 6 only a certain subset of all the music ever 7 recorded can be afforded to be stocked on 8 shelves, it's possible in the digital world, 9 and in a service like Rhapsody, to make, 10 ultimately, everything that's ever been 11 recorded available sort of at the click of a 12 mouse. 13 When you have access to that much 14 music, it means that people can -- people end 15 up listening to more than they would 16 otherwise. But, again, it's my team's job to 17 make sure that they do that because when you 18 provide people with -- we're up to almost 19 5 million tracks as of this morning in the 20 service. And when there's that much music, 21 it's easy for people to get paralyzed with too 22 much choice.</p>	<p style="text-align: right;">Page 4601</p> <p>1 is portability. The service -- you know, it's 2 what pundits call the celestial jukebox. The 3 service actually lives in the sky, 4 metaphorically. And our ultimate goal is to 5 get the music to you wherever you happen to 6 be. So that, you know, even if you're just 7 with a friend in a car, ultimately on a 8 plane -- we're not quite there yet -- as soon 9 as you think of a song, you should be able to 10 get to it and play it and listen to it, and 11 from there to more and more. 12 So as a songwriter and a musician 13 and a performer, you know, that thrills me, 14 the thought that making the music available 15 actually makes people listen to more music. 16 Q. In your testimony you explain music 17 adventure at paragraph 33. Can you walk the 18 court through what that music adventure is as 19 an example of what you're talking about? 20 A. Sure. So this is -- in the written 21 testimony in paragraph 33 it sort of walks you 22 through a specific case of what I was just</p>
<p style="text-align: right;">Page 4600</p> <p>1 So a lot of what we do is guide 2 people toward the specific music that they're 3 going to like so they don't get overwhelmed 4 with too much choice. So that people might 5 come into the service looking for one 6 particular hit, you know, that they heard on 7 the radio the other day, and from there 8 they -- you know, they might start out 9 thinking they're only going to listen to one 10 song, but we turn them on to other music based 11 on what we know they're listening to. So the 12 access and the recommendation and navigation 13 that comes with that is key to the service 14 that we provide. 15 And then also the fact that it's 16 available 24 hours a day, 7 days a week, 365 17 days a year whenever you want to hear music. 18 It doesn't matter if it's after midnight on a 19 Sunday night. Our record store is never 20 closed. Our service is never closed. It's 21 just always there. 22 And the final piece of that puzzle</p>	<p style="text-align: right;">Page 4602</p> <p>1 talking about. And the example that I used in 2 the written testimony was a hit song a couple 3 of years ago by a group called Gnarls Barkley, 4 "Crazy." And what we do with it in Rhapsody 5 is we don't just give you the music. We 6 provide a lot of information about that music. 7 And we provide paths from that music to other 8 music, which is how we get people listening to 9 more and more music more and more often. 10 So in this example what happens is 11 somebody comes into the system to hear that 12 song they heard on the radio. They search for 13 Crazy or they search for Gnarls Barkley. They 14 end up on the Gnarls Barkley artist page 15 within our system. And as they're listening 16 to the song, we provide a lot of information 17 about that song, about the artist. 18 So in this example, the listener is 19 hearing Crazy and reading the Gnarls Barkley 20 artist biography from which they learn that 21 Gnarls Barkley isn't a person; it's actually a 22 duo consisting of two people, a producer named</p>

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<p>1 Danger Mouse and a singer/rapper named Cee-Lo. 2 There is a convenient link right there. You 3 can click on Cee-Lo's name and go to Cee-Lo's 4 artist page where you will find many other 5 albums by Cee-Lo. So if you liked Crazy, you 6 get turned on to Cee-Lo's body of work. 7 In this example, the listener 8 selects a greatest hits album by Cee-Lo and 9 starts listening to that. And while this 10 listener is enjoying Cee-Lo's greatest hits, 11 they look at some playlists featuring tracks 12 by Cee-Lo. And in this case, the playlist 13 that the user finds wasn't even created by my 14 team; it was created by another user. It's a 15 playlist that's in the system called Sunday 16 Morning Cleaning that features some music by 17 Cee-Lo, but also music by Duke Ellington, Fela 18 Kuti. 19 And this customer decides, Oh, I 20 have heard of Duke Ellington, but I've never 21 actually heard Duke Ellington: I am a 22 Rhapsody subscriber. All I have to do is</p>	<p>1 key albums. They could go to Woody Herman; 2 they could go to Count Basie. 3 And this is the experience that we 4 repeat daily for, you know, hundreds of 5 thousands of users where people come in 6 looking for one song and end up listening to 7 multiple songs. 8 One of my -- the favorite parts of 9 my job is when I get e-mails or phone calls 10 from friends or acquaintances saying, darn it, 11 Quirk; I thought I just wanted to listen to 12 that one song, and before I knew it, two hours 13 had gone by. 14 Q. Does your experience and background 15 as an artist or a songwriter inform your view 16 about the benefits or the excitement? 17 A. Yes. Absolutely. The -- you know, 18 the most exciting thing to me about Rhapsody 19 is not just that people -- we provide an 20 opportunity for people to listen to more 21 music, but that simply making the music 22 available and providing the navigation that we</p>
Page 4604	Page 4606
<p>1 click on this button; it doesn't cost me 2 anything extra. All it costs me to listen to 3 this new music is my time; I am going to take 4 a chance on Duke Ellington. 5 So this person goes to the Duke 6 Ellington artist page. But, again, Duke 7 Ellington has dozens of albums available in 8 our system. If this user is new to Duke 9 Ellington, he or she doesn't know exactly 10 where to start, again, one of the services my 11 team provides is a helpful artist sampler, 12 basically the key tracks that we've selected, 13 our jazz expert has selected, by Duke 14 Ellington saying this is where to start. 15 So they play this playlist of key 16 Duke Ellington tracks. It starts with Satin 17 Doll and it ends with In a Sentimental Mood. 18 While the customer is listening to this music, 19 he or she could click on the genre that we 20 have classified Duke Ellington in -- in this 21 case, it's Big Band -- and could end up on the 22 Big Band genre page, looking at key artists,</p>	<p>1 do throughout that music, across that music, 2 sort of concretely changes the way people 3 experience the music. They do listen to more 4 and more varied types of music. 5 So there are some figures that are 6 in the written testimony that I use to 7 demonstrate this fact. And -- you know, as a 8 semi-successful recording artist myself, 9 someone who had more success than the average 10 musician ever does -- but, you know, not 11 Madonna-level success, it's particularly 12 exciting for me because as we add more and 13 more music into the system, what we've found 14 is very much an "if you build it they will 15 come" scenario where it doesn't seem to matter 16 how much more music we put in the system; the 17 same percentage of it continues to get 18 listened to. It's fascinating just how much 19 people listen to and how much they discover 20 music. 21 And the discovery piece is the key 22 thing to me, as a musician, a songwriter and</p>

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<p style="text-align: right;">Page 4607</p> <p>1 music fan, that makes me excited about the 2 service and my job, the service we provide, in 3 that people come in, you know, looking for a 4 hit in a lot of cases. But the service only 5 has value to them if it turns them on to more 6 music. 7 So the statistics I was talking 8 about in a sort of big box retailer, such as 9 Wal-Mart or Best Buy, they don't stock a lot 10 of different music. They just don't have that 11 much shelf space for it. So my understanding 12 is that about 48.5 percent of their sales come 13 from the top 100 artists. 14 If you drop the price and expand 15 the selection in an online retail environment, 16 such as iTunes or downloads that you can 17 purchase through Rhapsody, that percentage 18 drops. 19 So 33 percent of the music that 20 people purchase in an online music store comes 21 from the top 100 artists. So that shows that 22 people are sort of expanding their horizons;</p>	<p style="text-align: right;">Page 4609</p> <p>1 it, again, because all it costs them to access 2 new music is their time, and they demonstrate 3 a voracious appetite to listen to and download 4 and experience more music. 5 Q. Why is that important to you not as 6 a songwriter or artist, but as a 7 businessperson? 8 A. Well, as a businessperson, it's 9 important to me and it's -- the reason it's 10 the mandate for my team is to make sure people 11 are always listening to more and more varied 12 music because people will only remain 13 subscribers if they're getting continual value 14 out of the service. 15 So if they only listen to a few 16 songs and they listen to those same songs over 17 and over again, there is no reason to keep 18 paying us a monthly fee, whereas if every day, 19 every week, every month, every year we're 20 exposing them to new music that they wouldn't 21 have known about otherwise, the service 22 becomes valuable to them, and actually it</p>
<p style="text-align: right;">Page 4608</p> <p>1 they're listening to more and more varied 2 music. 3 If you go to peer-to-peer networks 4 where the selection is as limitless as you can 5 possibly get and the price is as low as you 6 can possibly get because it's free, because 7 they're not paying anybody for it, 28 percent 8 of the files that are traded in a given month 9 come from the top 100 artists. So, again, as 10 the selection expands and the price lowers, 11 people become more adventurous. 12 And the thing that I am proudest of 13 in Rhapsody is that we actually beat peer to 14 peer for music discovery. In a given month in 15 Rhapsody we have over 100 million plays of -- 16 or accesses of songs in a given month, and 17 24 percent of those come from -- less than 18 24 percent come from the top 100 artists. So 19 this demonstrates to me that when people get 20 into a service that doesn't just provide the 21 music, but provides you a means of navigating 22 through it, people actually take advantage of</p>	<p style="text-align: right;">Page 4610</p> <p>1 becomes worth paying for even though all the 2 music we're providing is available completely 3 for free elsewhere on peer-to-peer services. 4 Q. One of the things I wanted to ask 5 you about, turning to page 19, if you could, 6 tables 2 and 3 -- do you see those? 7 A. I do. 8 Q. What are they? 9 A. They -- well, they're 10 demonstrations of what people call the 11 long tail phenomenon. They show you the 12 number of plays of -- the top chart is the 13 top 100 tracks and the bottom chart is the 14 top 1,000 tracks -- based on popularity of the 15 track. 16 Q. Does this reflect or represent what 17 you were testifying to? 18 A. It absolutely does. It shows you 19 that, you know, the -- say the top 10 or the 20 top 100 hundred tracks, as you can see, 21 receive a high amount of plays because there 22 are lots of people listening to them once or</p>

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<p>1 twice. But as you go farther down what's</p> <p>2 called the long tail, you know, the total</p> <p>3 number of plays per track or accesses per</p> <p>4 track drops, but it doesn't drop to zero. So</p> <p>5 it shows you that once you make this music</p> <p>6 available -- a lot of this music you couldn't</p> <p>7 even find in a store; you would never hear on</p> <p>8 the radio. If you give people a means to</p> <p>9 access it, they take advantage of that.</p> <p>10 Q. Do you have any idea where your</p> <p>11 music would be on that?</p> <p>12 A. I do. I check it every month. I</p> <p>13 believe Too Much Joy is hovering around the --</p> <p>14 between 4,000 and 5,000 in artist rank in a</p> <p>15 given month. Wonderlick, unfortunately, is</p> <p>16 much farther down than that.</p> <p>17 Q. How does that compare to</p> <p>18 traditional physical retail?</p> <p>19 A. Well, in traditional physical</p> <p>20 retail, everybody from, say -- it depends on</p> <p>21 just how big the store would be. But it would</p> <p>22 be very rare to find people outside the top,</p>	<p>1 sure -- as I mentioned before, the 365 --</p> <p>2 having it available 24 hours a day, 7 days a</p> <p>3 week, 365 days a year when, potentially,</p> <p>4 millions of people are accessing the system at</p> <p>5 the same time and playing songs and</p> <p>6 downloading songs, building the technological</p> <p>7 infrastructure to allow that is an incredibly</p> <p>8 expensive undertaking, and it's not an expense</p> <p>9 that you just do once and it's done. It's</p> <p>10 something you constantly have to maintain and</p> <p>11 keep going.</p> <p>12 And just as one illustrative</p> <p>13 example, you know, we traditionally see a big</p> <p>14 spike on Christmas Day when people buy new</p> <p>15 Rhapsody-enabled devices or get Rhapsody</p> <p>16 subscriptions as gifts, and everybody runs to</p> <p>17 their computer and starts playing around with</p> <p>18 it. So we see a huge spike in usage on that</p> <p>19 day.</p> <p>20 Just last year, I would say the</p> <p>21 bulk of our development team spent at least</p> <p>22 six, if not eight weeks, doing little beyond</p>
Page 4612	Page 4614
<p>1 say, 1,000, 2,000, at the max top 5,000</p> <p>2 artists.</p> <p>3 We go from -- we have close to</p> <p>4 250,000 different artists in the system right</p> <p>5 now. So -- I'm bad at math; I don't know what</p> <p>6 the exact percentage would be, but I'm</p> <p>7 thinking it's over 90 percent of that just</p> <p>8 wouldn't be available in a store and you would</p> <p>9 never hear it on radio, or almost never hear</p> <p>10 it on radio.</p> <p>11 Q. So you've described the access, and</p> <p>12 I want to ask you, from your understanding,</p> <p>13 how expensive it is to provide this sort of a</p> <p>14 service?</p> <p>15 A. It is incredibly expensive. It's</p> <p>16 "lose sleep at night over it," "lose sleep at</p> <p>17 night about it" expensive.</p> <p>18 The written testimony breaks down</p> <p>19 some of the details of the different areas</p> <p>20 where the expenses are. But sort of as a</p> <p>21 general theme, just providing that large a</p> <p>22 catalog of music to a mass audience and making</p>	<p>1 preparing for Christmas Day to make sure that</p> <p>2 the system wouldn't fall over on Christmas</p> <p>3 Day.</p> <p>4 Of Christmas Day -- of course, the</p> <p>5 activity we saw in 2006 and 2007 on Christmas</p> <p>6 Day is where we eventually want the service to</p> <p>7 be -- we just want that level of activity to</p> <p>8 be a typical Wednesday in March. So it's a --</p> <p>9 it requires constant investment to keep the</p> <p>10 system up and running.</p> <p>11 And the problem for us is that the</p> <p>12 service is only valuable to the extent that we</p> <p>13 have exactly what you're looking for exactly</p> <p>14 when you're looking for it. So all we have to</p> <p>15 do is fall over once or not have that one, you</p> <p>16 know, Duke Ellington song that you're looking</p> <p>17 for -- some people start with Duke Ellington</p> <p>18 and end up at Crazy -- and the service</p> <p>19 suddenly loses its value for you, and we lose</p> <p>20 subscribers.</p> <p>21 Q. In your written testimony you</p> <p>22 discuss facing competition in paragraph 44.</p>

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<p>1 Can you summarize for the court what you view 2 as your primary competition? 3 A. To my mind, our primary competition 4 is unlicensed peer-to-peer music services 5 because they provide a wider catalog than we 6 do at a lower price. And as, you know, a 7 songwriter and a musician, that offends me 8 somewhat because nobody is getting paid for 9 any of that use. 10 So my team's job and my company's 11 job, Rhapsody's job, is to provide a better 12 experience than peer to peer. We need to make 13 it easier to use, more valuable. We need to 14 do things that peer to peer can't in order to 15 convince people that it's worth paying money 16 for music and for access to music in this 17 manner. 18 Q. When you say you need to do those 19 things, is there an expense involved with it? 20 A. Absolutely. I mean, marketing, 21 again, is a huge expense partly because what 22 Rhapsody is trying to do is to a large extent</p>	<p>1 wherever you are. It started out on the PC, 2 but there's a limited audience for listening 3 to music on your computer. We need to get it 4 into people's stereos, onto people's home 5 entertainment centers, in their pockets on 6 devices, eventually on mobile phones and in 7 cars. And -- so explaining to people that 8 music as a service is different than, 9 quote/unquote, owning music is incredibly 10 challenging. 11 One of the sort of themes that we 12 combat in the press a lot is the notion that, 13 at iTunes, you buy music and own it forever 14 whereas, through a subscription service like 15 Rhapsody, you're simply renting music. It's a 16 very convenient shorthand that I think is just 17 mind-bogglingly wrong. Rhapsody is not a 18 music rental service. It's -- it's a service 19 that provides access to anything you can think 20 of whenever you want. It's not like, oh, you 21 rent a video from Blockbuster and then you 22 return it after a day or two. The music</p>
Page 4616	Page 4618
<p>1 change the way people think about music, 2 change the way they think about experiencing 3 music. 4 So we don't just have to advertise 5 the fact that our service exists; we have to 6 advertise what it does and why it's valuable. 7 It's not something that you can explain, you 8 know, in 30 seconds. It requires constant 9 reinforcement. 10 Q. What do you mean by change the way 11 people think about music? 12 A. Well, the primary value proposition 13 of Rhapsody is that it's music as a service. 14 What you're paying for isn't necessarily a 15 specific track or album or set of tracks or 16 albums. You're paying for access to music, so 17 again, 24/7 access to music, so that whatever 18 you think about wherever you are, whenever it 19 happens to be you can get to it right away. 20 You know, our big goal, as I think 21 I mentioned before, is to make the experience 22 as portable as possible so that it follows you</p>	<p>1 doesn't go away. It's just always there 2 whenever you want it. 3 Q. One of the things, going back to 4 competition, that you present in your written 5 testimony is the issue of pricing and price 6 increases. I wanted to ask you if you can 7 summarize for the court the arguments against 8 raising price that are presented in your 9 testimony. 10 A. Well, that are presented in the 11 testimony -- the general idea is that we 12 are -- it's a new business, it's the early 13 days of this new business, and we are 14 competing with music for free. So it is very 15 difficult for us to wean people off of piracy, 16 off of music for free if the price point is 17 too high. And we absolutely need the 18 flexibility to experiment with different ways 19 of providing the service, different price 20 points. 21 To the extent that, you know, there 22 are sort of set licensing costs that we have</p>

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<p>1 to pay, it -- you know, that places a floor 2 below which we can't go in terms of offering 3 this service to potential customers. And I am 4 convinced that the way to truly get scale in 5 this business is to become way more flexible 6 in how we offer it.</p> <p>7 And we can -- you know, the general 8 idea is that there's more money to be made for 9 everybody. The problem is if we, you know -- 10 if we try to ensure that we are paying content 11 owners exactly what they're getting in the 12 physical world and try to map that into the 13 digital world, that completely ignores the 14 fact that in the digital world everything is 15 already available for free. We didn't create 16 that reality. We're just trying to combat 17 that reality.</p> <p>18 Q. Since the filing of your testimony, 19 has Rhapsody experimented with or implemented 20 different pricing?</p> <p>21 A. We have.</p> <p>22 Q. Can you tell the court about that?</p>	<p>1 relationship with, that's the way to do it, 2 So people are used to paying their 3 mobile phone provider for a service. If they 4 could add on Rhapsody for a, you know, small 5 price on top of that, we could go from, say, 6 you know, hundreds of thousands or low 7 millions of subscribers to tens of millions or 8 even hundreds of millions of subscribers.</p> <p>9 Q. Let me ask you, are you aware of 10 the rates proposed by DiMA in this proceeding?</p> <p>11 A. I am.</p> <p>12 Q. Do you support those rates?</p> <p>13 A. I do.</p> <p>14 Q. Can you tell the court why?</p> <p>15 A. Well, what I learned in my own 16 experience as a songwriter and musician is 17 that the -- a percentage of revenue model 18 works, and there's -- the example for this, 19 you know, in the music business, to my mind, 20 is the way broadcast -- traditional broadcast 21 radio works right now. It works great for 22 publishers and songwriters, doesn't work for</p>
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<p>1 A. Sure. In -- I believe it was 2 April of '07, so close to a year ago, we 3 raised the price of our Rhapsody Unlimited 4 offering. So that's not the portable piece 5 that gives you the portable conditional 6 downloads. It's just the access to the 7 service sort of on demand. We raised the 8 price from 9.99 a month to 12.99 a month.</p> <p>9 Q. And why was that done?</p> <p>10 A. Well, at the time, it was the most 11 rational business move we could make, given 12 our existing costs at that time.</p> <p>13 Q. What do you believe is the next 14 rational step, then?</p> <p>15 A. To my mind, the next rational step 16 is to experiment with far lower prices. I 17 think that's how you get scale in this 18 business.</p> <p>19 I also think that to the extent 20 that we can bundle the service with other 21 offerings, people who -- you know, services 22 that people already have an existing billing</p>	<p>1 labels and performers right now because 2 they're not getting a piece of it.</p> <p>3 But the publishers and the 4 songwriters are getting a piece of radio 5 revenue. Radio can play whatever they want as 6 long as it has been commercially released. 7 They can play it as often as they want. They 8 don't have to worry -- you know, the meter 9 isn't ticking up the more music they play or 10 the more different music they play. They 11 don't need to go out and negotiate for an 12 individual license from every single content 13 provider. They're just able to do it.</p> <p>14 Most of the money that I saw as 15 a -- you know, in my career as -- the ten 16 years that I spent doing music 24/7, most of 17 the music [sic] that I saw came from 18 publishing. So I know that works.</p> <p>19 And, more importantly, in an 20 environment like this, what it does is it 21 reasonably allocates both the risks and the 22 benefits of trying to start a business like</p>

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<p>1 this. It says that it doesn't matter, you 2 know, how much money you're guaranteed in 3 advance to get if the companies don't actually 4 make any money. So 90 percent of zero is far 5 less than, say, 4 percent of 1, you know. 6 So the way I look at it, this is -- 7 our proposal is the best way to grow the music 8 business. You know, I mean, it's the metaphor 9 everybody uses, but it's making the pie a lot 10 bigger. 11 Q. Would you consider the DiMA 12 proposal to be a rate cut? 13 A. Absolutely not. It's a completely 14 different way of calculating what's owed. 15 Q. How so? 16 A. It's a percentage of revenue model 17 as opposed to saying, oh, okay, for every 18 track you owe this many pennies. 19 Q. Are you familiar with the terms 20 that DiMA has proposed? 21 A. I am. 22 Q. Do you support them?</p>	<p>1 one type of portable device, it might be in 2 one bit rate; another device might support a 3 different bit rate. 4 So we have to make multiple copies 5 of the same song just so that however 6 different subscribers want to access it, we 7 can provide it to them. But all those copies, 8 in a very real sense, are ephemeral in that 9 nobody is actually accessing that -- you know, 10 that particular copy of the song; it's just 11 part of the delivery mechanism. As we're 12 downloading a song to somebody's computer, as 13 they're transferring it from their computer to 14 their device, multiple copies are being made. 15 But the only one that really matters in an 16 economic sense is the final one that the user 17 is accessing and listening to. 18 Q. You testified earlier that you 19 receive royalty checks still? 20 A. Yes. 21 Q. Performance and mechanical? 22 A. Yes.</p>
Page 4624	Page 4626
<p>1 A. I do. 2 Q. I want to cover them just briefly. 3 Can you explain why it's important to ensure 4 that all copies made in the process of 5 delivering a download are covered by the 6 license? 7 A. Yes. The reason it's important is 8 that in order to provide the service that we 9 do, multiple copies of every single track in 10 the system have to be made just to enable 11 getting that final copy to an end customer. 12 And all those multiple copies in between, from 13 the record company delivering us a version of 14 the song, us making an archive copy of it, us 15 then encoding that track into several 16 different formats so that if you're trying to 17 access the track from a mobile phone, for 18 instance, you're going to get it in one -- 19 what we call a codec or format. 20 If you're accessing it from a PC, 21 it could be in a completely different format. 22 If you access it as a conditional download to</p>	<p>1 Q. So from the perspective of a 2 businessperson and a recipient of royalties, 3 do you have an understanding of the DiMA 4 proposal for defining revenues on which the 5 rate would be applied? 6 A. I do. 7 Q. Can you explain that to the court? 8 A. Sure. Well, it sort of breaks down 9 in two ways. The first is -- and I forget 10 what the exact legal term is. I think it's 11 applicable fees, something like that. So for 12 a permanent download we basically say, okay, 13 it's a percentage of the price that is paid 14 for that particular track. And, of course, as 15 the price varies, the percentage -- you know, 16 the actual revenue that you see from that 17 varies depending on the price. 18 For the limited or conditional 19 downloads, the way it works is -- I will just 20 use a single subscriber to illustrate it. If 21 we charge a single subscriber, say, \$15 a 22 month and that subscriber then accesses 100</p>

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<p>1 songs, and 50 of those songs they stream 2 on-demand and 50 of those songs they download 3 as limited downloads -- perhaps they transfer 4 to a portable device -- we say, okay. 5 50 percent of that customer's use was applied 6 to conditional downloads. So we take 7 50 percent of the \$15 that the customer gave 8 us, and we say \$7.50 from that customer is 9 what we allocate across the conditional 10 downloads. So me, as a songwriter and 11 publisher, if 10 of those 50 songs happily 12 were Too Much Joy songs -- 13 Q. Optimistically. 14 A. No, it's not optimistically. I 15 play Too Much Joy ten times a month. 16 If ten of those songs were Too Much 17 Joy songs, what would happen is we would take 18 the percentage, which is 4 percent, we would 19 multiply it by the number of Too Much Joy 20 songs as the numerator, which is ten. The 21 denominator would be the total number of 22 conditional downloads, which is 50. So it</p>	<p>1 THE WITNESS: I believe there are. 2 JUDGE ROBERTS: How so? 3 THE WITNESS: Well, in that case, 4 the -- Apple has taken in some money. It 5 would be reasonable to say, okay, then let's 6 look at how much music gets used in that 7 scenario. What was the price the person paid? 8 And you could divvy up, based on the amount of 9 music that was used, what percentage of it 10 gets calculated. 11 JUDGE ROBERTS: But they didn't pay 12 for any of the music. They got a year's free 13 worth of subscription. 14 THE WITNESS: But they -- well, 15 they got a year's subscription and a device 16 for a price. 17 JUDGE ROBERTS: Yes. How would you 18 allocate to the device? 19 THE WITNESS: Well, I don't know, 20 because that's not the business that we're in. 21 JUDGE ROBERTS: So in that 22 situation, you wouldn't know how to decide</p>
Page 4628	Page 4630
<p>1 would be 4 percent times 10 over 50 times 2 \$7.50, the 50 percent of the customer's 3 subscription fee that's attributable to 4 conditional downloads. 5 MR. LAGUARDA: Thank you. I have 6 no further questions. 7 JUDGE ROBERTS: I have a question 8 for you, Mr. Quirk. You were describing how 9 you calculate revenue. Let us say that 10 iTunes, in order to sell the latest, newest 11 version of the iPod, says that if you purchase 12 this new iPod, we will give you one year free 13 subscription to the music in the iTunes Store. 14 What would be the revenue 15 determination in that situation? Now, 16 obviously, the new iPod is more expensive than 17 the old one, presumably because it's better, 18 and it comes with this terrific one year free 19 subscription to the music. Is there any 20 revenues in that situation that are 21 attributable for purposes of paying a license 22 fee?</p>	<p>1 what the revenue should be and how the 2 4 percent rate should apply in that instance? 3 THE WITNESS: No, I wouldn't know 4 exactly how you would break it down, I don't. 5 JUDGE ROBERTS: Thank you. 6 CHIEF JUDGE SLEDGE: How does the 7 rate that you support do it? 8 THE WITNESS: Well, as I said 9 before, you know, to my mind, there is music 10 use occurring. Some of the price that is paid 11 is attributable to the device and some of the 12 price that is paid is attributable to the 13 music that is going on that device. 14 So just as we say we're taking in 15 \$15 from a customer for our Rhapsody service, 16 but not all of that \$15 goes to the 17 conditional downloads, you know, to my mind, 18 there is a clear-cut way of saying, okay, this 19 is the percentage of the downloaded music that 20 you apply the calculation to. 21 I imagine in that scenario that 22 there would be a way to make a similar</p>

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<p>1 determination, but again, that's not the 2 business that we're in, so I don't know how to 3 say exactly how you would do it. 4 CHIEF JUDGE SLEDGE: Does the rate 5 that you support do that? 6 THE WITNESS: I believe it can, 7 yes. 8 CHIEF JUDGE SLEDGE: Does it? 9 THE WITNESS: I don't know that 10 it -- no, it does not break down here is how 11 you would react to that specific situation. 12 JUDGE WISNIEWSKI: One further 13 question prior to this -- just generally. In 14 your written testimony here at paragraph 8 15 when you're talking about the type of 16 subscription service you have and when you're 17 suggesting a reason why, I take it -- or I'm 18 inferring from this paragraph that you should 19 pay a lower rate. You say, "Subscription 20 services provide an alternative to unlicensed 21 file trading, but the notion of paying for 22 access to music rather than owning music is</p>	<p>1 repeat the question? 2 JUDGE WISNIEWSKI: Yes. How would 3 you say that your situation, then, compares to 4 a service that provides permanent downloads? 5 Should they have to pay a higher rate because 6 they don't have to go through all these things 7 that you're suggesting that you go through? 8 THE WITNESS: I think if you're 9 only in that business, there is a case to be 10 made that -- that you don't have the similar 11 risks that somebody trying to do both has. 12 JUDGE WISNIEWSKI: How does that 13 square with the DiMA proposal which doesn't 14 distinguish between the two? 15 THE WITNESS: It does not square 16 precisely with that. 17 JUDGE WISNIEWSKI: Thank you. 18 CHIEF JUDGE SLEDGE: 19 Cross-examination? 20 MR. JOHNSON: Yes, Your Honor. 21 CROSS-EXAMINATION 22 BY MR. JOHNSON:</p>
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<p>1 new to consumers. This attempts to change 2 decades of attitudes about obtaining, 3 listening to and sharing music." 4 And I take it that you're 5 suggesting that there is a lot of investment 6 and time that has to take place and, 7 therefore, that's why you feel you should pay 8 this lower rate, or one of the reasons why; is 9 that correct? 10 THE WITNESS: It is, although I 11 would frame it slightly differently. I would 12 say it's why we believe we can't set the rates 13 artificially high, because it would inhibit us 14 from being able to make that change in 15 consumers' minds. 16 JUDGE WISNIEWSKI: How does that 17 compare, then -- would you suggest that that 18 argues that you should have a lower rate than 19 someone who is providing access to the 20 ownership of music, such as a service 21 providing permanent downloads? 22 THE WITNESS: I'm sorry. Could you</p>	<p>1 Q. Good afternoon, Mr. Quirk. My name 2 is -- good morning. My name is Jeh Johnson, 3 and I represent the copyright owners. I will 4 be asking you some questions. 5 First of all, could you look at 6 your written statement in front of you, 7 Exhibit 7, please. And if you look at the 8 last page, your signature line, you will see 9 that the particular document that you have in 10 front of you is dated November 17, '06; is 11 that correct? 12 A. Yes. 13 Q. That's the day you signed that 14 particular document in front of you? 15 A. Yes. 16 Q. Okay. And do you recall that you 17 also submitted or resubmitted another 18 statement, identical in nature, in April '07? 19 A. Me personally? 20 Q. Yes. 21 A. I don't recall that. 22 Q. You don't recall signing another</p>

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<p>1 statement in April '07?</p> <p>2 A. I don't.</p> <p>3 MR. JOHNSON: Your Honor, may I</p> <p>4 approach the witness?</p> <p>5 CHIEF JUDGE SLEDGE: Yes, sir.</p> <p>6 BY MR. JOHNSON:</p> <p>7 Q. Mr. Quirk, I am going to show</p> <p>8 you --</p> <p>9 MR. JOHNSON: Your Honor, I do not</p> <p>10 have extra copies of the particular version I</p> <p>11 want to show the witness, I hope that's</p> <p>12 acceptable. I just want to see if I can</p> <p>13 refresh his recollection about having signed a</p> <p>14 subsequent statement in April '07.</p> <p>15 CHIEF JUDGE SLEDGE: It's not in</p> <p>16 compliance with our rules. Mr. Laguarda?</p> <p>17 MR. LAGUARDA: Your Honor, if I can</p> <p>18 eliminate the confusion, the filing process in</p> <p>19 this proceeding --</p> <p>20 CHIEF JUDGE SLEDGE: Are you going</p> <p>21 to testify, Mr. Laguarda?</p> <p>22 MR. LAGUARDA: No, Your Honor. I</p>	<p>1 Q. "Setting a royalty rate that is too</p> <p>2 high would spell the end of our business</p> <p>3 model. An excessive rate would severely</p> <p>4 disrupt the digital music marketplace and</p> <p>5 result in a fatal loss of consumer</p> <p>6 confidence."</p> <p>7 Do you see that?</p> <p>8 A. Yes.</p> <p>9 Q. Do you stand by that statement as</p> <p>10 you sit here today?</p> <p>11 A. I do.</p> <p>12 Q. All right. Now, you refer to an</p> <p>13 excessive rate in paragraph 64 and say that an</p> <p>14 excessive rate would be fatal -- would be a</p> <p>15 fatal loss -- result in a fatal loss of</p> <p>16 consumer confidence, but you don't put a</p> <p>17 number on that paragraph. And I'm asking you,</p> <p>18 would 15 percent, in your view, of revenue</p> <p>19 from limited downloads be fatal -- be a fatal</p> <p>20 loss of consumer confidence?</p> <p>21 A. I don't know that I would say -- I</p> <p>22 don't know what the exact rate that is too</p>
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<p>1 was --</p> <p>2 CHIEF JUDGE SLEDGE: Don't.</p> <p>3 Mr. Johnson?</p> <p>4 BY MR. JOHNSON:</p> <p>5 Q. Mr. Quirk, you do not recall</p> <p>6 signing another statement on April 6, '07?</p> <p>7 A. I don't recall it. I'm not saying</p> <p>8 I didn't. I just don't recall it.</p> <p>9 Q. If you look at page 64 of your</p> <p>10 statement, please. I'm sorry. Paragraph 64,</p> <p>11 page 34. The statement reads as follows:</p> <p>12 "The market for legitimate digital music</p> <p>13 services is already fragile."</p> <p>14 Do you see that?</p> <p>15 A. Yes.</p> <p>16 Q. Okay. And is it your belief that</p> <p>17 the market for legitimate digital music</p> <p>18 services was fragile as of November 2006?</p> <p>19 A. Yes.</p> <p>20 Q. Do you still consider it fragile as</p> <p>21 you sit here today?</p> <p>22 A. Absolutely.</p>	<p>1 high is.</p> <p>2 Q. Well, do you know what the</p> <p>3 copyright owners' proposal is with respect to</p> <p>4 limited downloads?</p> <p>5 A. Not off the top of my head, no.</p> <p>6 Q. If I represented to you that it was</p> <p>7 15 percent of licensees' receipts of limited</p> <p>8 downloads, would 15 percent break the bank, in</p> <p>9 your view?</p> <p>10 A. At this point in time, given</p> <p>11 Rhapsody's business, my answer is probably</p> <p>12 yes, it would.</p> <p>13 Q. It's your testimony that a rate of</p> <p>14 15 percent would result in a fatal loss in</p> <p>15 consumer confidence?</p> <p>16 A. No. My testimony is that a</p> <p>17 15 percent loss would be fatal to my business.</p> <p>18 Q. Well, you say in paragraph 64, "An</p> <p>19 excessive rate would severely disrupt the</p> <p>20 digital music marketplace and result in a</p> <p>21 fatal loss of consumer confidence."</p> <p>22 I am asking you to put a number on</p>

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<p>1 what an excessive rate is. My question is, in 2 your view, are you testifying that 15 percent 3 is an excessive rate, to use your phrase, that 4 would result in a fatal loss of consumer 5 confidence? 6 A. When you frame it that way, yes, I 7 am. 8 Q. We're talking about the mechanical 9 royalty rate payable to songwriters and 10 publishers, correct? 11 A. Yes. 12 Q. All right. And you know that you 13 pay a lot more in royalty rates to record 14 companies with respect to sound recording 15 royalties, right? 16 A. I don't know what the exact 17 percentage is, but -- 18 Q. You know it's a lot higher than 19 15 percent, right? 20 A. I know we paid more to record 21 companies than to publishers. 22 Q. By multiples of 15 percent,</p>	<p>1 A. I believe a fair and reasonable 2 rate is necessary for our business to survive, 3 and I believe 4 percent is a fair and 4 reasonable rate. 5 Q. And is 4 percent necessary for your 6 business to survive as opposed to 5 or 6 or 7 8 percent? 8 A. I don't know that I can say it's 9 necessarily that figure. 10 Q. It could be 8, could be 9? 11 A. Reasonable people can disagree, 12 yes. 13 Q. Okay. Now, let's look at 14 paragraph 58, please -- last sentence of 15 paragraph 58, page 32 of Exhibit 7. We're 16 going to go through paragraph 58 in a lot more 17 detail, but in paragraph 58 you talk about 18 royalty rates. And in the last sentence you 19 say, "Royalty payments take up the bulk of our 20 product margins." 21 Do you see that? 22 A. Yes.</p>
Page 4640	Page 4642
<p>1 correct? 2 A. I'm not disputing it. I don't know 3 if for a fact. 4 Q. And those deals were deals that you 5 made with the record companies beginning in 6 2002, correct? 7 A. Yes. 8 Q. And I assume that, in 2002, your 9 business was a lot more fragile then than it 10 is today, right, given how far you have come? 11 A. It is -- I would say it has been 12 fairly consistently fragile. 13 Q. Now, you understand that the DiMA 14 proposal is for 4 percent of a licensee's 15 receipts, correct? 16 A. Yes. 17 Q. With respect to limited downloads? 18 A. Yes. 19 Q. Okay. And is it your testimony 20 that a rate of 4 percent, that low, is 21 necessary for your business to survive, 22 4 percent?</p>	<p>1 Q. Now, when you said, "Royalty rates 2 take up the bulk of our product margins," 3 you're not referring to mechanical royalty 4 rates paid to songwriters and publishers, are 5 you? 6 A. Well, for -- it depends what you're 7 saying. We're including all royalty rates in 8 that statement. 9 Q. Well, the royalty rates that you're 10 referring to in that statement are sound 11 recording royalties paid to the record 12 companies pursuant to the agreements you've 13 made with them, right? 14 A. It includes sound recording 15 payments, yes. 16 Q. In fact, that is the overwhelming 17 majority of royalty payments you that make? 18 A. They are the majority, yes. 19 Q. So when you complain about royalty 20 payments, in paragraph 58, taking up the bulk 21 of your product margins, you're referring to 22 the sound recording royalty payments that you</p>

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<p>1 make pursuant to the deals you made with the</p> <p>2 record companies, right?</p> <p>3 A. We're referring to all royalty</p> <p>4 payments that we have to make.</p> <p>5 Q. Well, let's look at Exhibit E,</p> <p>6 please, of your statement. And I am going to</p> <p>7 have specific questions with regard to</p> <p>8 Exhibit E.</p> <p>9 CHIEF JUDGE SLEDGE: Mr. Laguarda?</p> <p>10 MR. LAGUARDA: Your Honor, if the</p> <p>11 witness is going to testify about Exhibit E,</p> <p>12 and Mr. Johnson has represented the questions</p> <p>13 will be detailed, that exhibit is protected</p> <p>14 pursuant to the court's ruling, and I would</p> <p>15 ask that the provisions of the protective</p> <p>16 order be applied for the duration of the</p> <p>17 questioning.</p> <p>18 CHIEF JUDGE SLEDGE: Any objection?</p> <p>19 MR. JOHNSON: No objection, Your</p> <p>20 Honor.</p> <p>21 CHIEF JUDGE SLEDGE: Without</p> <p>22 objection, the motion is granted. Rather than</p>	<p>1 BY MR. JOHNSON:</p> <p>2 Q. Mr. Quirk, could you look at</p> <p>3 paragraph 58, please?</p> <p>4 A. In the annual report?</p> <p>5 Q. Of your written statement. By the</p> <p>6 way, something else in your written statement</p> <p>7 while you're going there. I believe in your</p> <p>8 written statement -- and I don't think this is</p> <p>9 protected -- you started with 48,000 songs in</p> <p>10 your catalog; is that right?</p> <p>11 A. Correct.</p> <p>12 Q. And as of 2006 you had 3.3 million</p> <p>13 songs in your catalog, right?</p> <p>14 A. I believe so, yes.</p> <p>15 Q. And I think you said this morning</p> <p>16 that as you sit here on February 26, 2008, you</p> <p>17 have 5 million songs in your catalog?</p> <p>18 A. We're just shy of 5 million.</p> <p>19 Q. Okay. So in terms of songs in your</p> <p>20 catalog, that's definitely a growing business,</p> <p>21 right?</p> <p>22 A. It's a growing catalog.</p>
Page 4644	Page 4706
<p>1 people leaving at this time, when it's noon,</p> <p>2 we will recess for one hour.</p> <p>3 (Recess.)</p> <p>4</p> <p>5</p> <p>6</p> <p>7</p> <p>8</p> <p>9</p> <p>10</p> <p>11</p> <p>12</p> <p>13</p> <p>14</p> <p>15</p> <p>16</p> <p>17</p> <p>18</p> <p>19</p> <p>20</p> <p>21</p> <p>22</p>	<p>1 Q. Okay. Now, look at paragraph 58,</p> <p>2 please, of your written statement, page 31,</p> <p>3 you state, "Our business operates within an</p> <p>4 overly complex and unnecessarily cumbersome</p> <p>5 licensing scheme."</p> <p>6 Do you see that?</p> <p>7 A. I do.</p> <p>8 Q. Now, we have already established</p> <p>9 that mechanical royalties for permanent</p> <p>10 downloads of songs that you sell are paid by</p> <p>11 the record companies, right?</p> <p>12 A. Yes.</p> <p>13 Q. You don't have to pay those</p> <p>14 royalties. The record companies take care of</p> <p>15 that for you, right?</p> <p>16 A. Correct.</p> <p>17 Q. And we have already established, I</p> <p>18 think, that with respect to limited downloads</p> <p>19 you don't have a licensing agreement with</p> <p>20 Harry Fox or the publishers or the songwriters</p> <p>21 right now, right?</p> <p>22 A. Correct.</p>

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<p>1 Q. There is a blanket agreement 2 pursuant to which you pay an initial monthly 3 fee, which is referred to in paragraph 58, and 4 a monthly five-figure fee, right?</p> <p>5 A. Yes.</p> <p>6 Q. And that's regarded as interim in 7 nature, right?</p> <p>8 A. I believe so, yes.</p> <p>9 Q. And you know the amounts specified 10 in this paragraph are far below what you're 11 likely to end up having to actually pay, 12 right?</p> <p>13 A. I don't know that.</p> <p>14 Q. Okay. Now, you know that these are 15 interim arrangements, right?</p> <p>16 A. Yes.</p> <p>17 Q. You don't know the estimate that 18 has been accrued?</p> <p>19 A. Correct.</p> <p>20 Q. Now, you stated at paragraph 57 21 that -- and here you're referring to consumer 22 price for your service -- "We have seen that</p>	<p>1 30 percent, were you?</p> <p>2 A. The handcuffing that I am referring 3 to in my testimony is our inability to price 4 lower.</p> <p>5 Q. Inability to price lower?</p> <p>6 A. Correct.</p> <p>7 Q. So there's nothing to prevent you 8 from pricing higher?</p> <p>9 A. Well, only the fact that people 10 won't pay, but there's nothing in our 11 agreements that prevents us from pricing 12 higher, no.</p> <p>13 Q. Okay. Now, in your statement in 14 paragraph 22 you use the phrase 15 "platform-agnostic." "While most of the 16 individual product offerings described above 17 require a PC for access, our ultimate goal is 18 to make Rhapsody platform-agnostic."</p> <p>19 Do you see that?</p> <p>20 A. Yes.</p> <p>21 Q. "In order to be a true celestial 22 jukebox, the Rhapsody service needs to be</p>
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<p>1 there is -- that there is a price for our 2 service above which customers are not willing 3 to pay. As it is now, we are all but 4 handcuffed in our ability to price creatively 5 to attract subscribers."</p> <p>6 Do you see that?</p> <p>7 A. I do.</p> <p>8 Q. Okay. Now, if you look at 9 paragraph 14 of this statement you will see 10 that the price for Rhapsody Unlimited as of 11 the point when you signed this in November '06 12 was a monthly fee of \$9.99, right?</p> <p>13 A. Correct.</p> <p>14 Q. And you subsequently -- you have 15 raised the monthly fee for Rhapsody Unlimited 16 to \$12.99, right?</p> <p>17 A. Correct.</p> <p>18 Q. And I think you said this morning 19 that you did that in April 2007, right?</p> <p>20 A. Correct.</p> <p>21 Q. So you weren't handcuffed to be 22 able to raise the price for Rhapsody Unlimited</p>	<p>1 accessible anywhere our customers find 2 themselves, not just at their computers, but 3 in their living rooms, in their cars, at the 4 beach, on airplanes and on trains."</p> <p>5 Now, my question is, in the context 6 of submitting this written statement for 7 purposes of setting a mechanical royalty rate, 8 why did you tell us that?</p> <p>9 A. We're trying to explain what the 10 nature of the service is.</p> <p>11 Q. Is there any other purpose? Are 12 you trying to demonstrate that there is some 13 mountain you have to climb in order to get to 14 where you want to be?</p> <p>15 A. Yes. That's a fair -- that's a 16 fair statement.</p> <p>17 Q. And you said this morning that your 18 ultimate goal was to get music to people 19 wherever they happened to be?</p> <p>20 A. Correct.</p> <p>21 Q. All right. Now, you said this in 22 November '06, right? And in August 2007 your</p>

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<p style="text-align: right;">Page 4711</p> <p>1 company entered into agreements with MTV 2 Networks and Verizon Wireless, correct? 3 A. Correct. 4 Q. Let me show you what has been 5 marked as Copyright Owners' Exhibit 144 for 6 identification. Have you seen Exhibit 144 7 before? 8 A. I have. 9 Q. And you are an addressee to the 10 e-mail that precedes the press release, right? 11 A. Correct. 12 Q. And this e-mail and this press 13 release refers to the agreement that was 14 reached in August '07 with MTV Networks and 15 Verizon Wireless, right? 16 A. Correct. 17 MR. JOHNSON: I offer Exhibit 144 18 in evidence. 19 CHIEF JUDGE SLEDGE: Any objection 20 to 144? 21 MR. LAGUARDA: No objection, Your 22 Honor.</p>	<p style="text-align: right;">Page 4713</p> <p>1 MTV Networks and Verizon Wireless are joining 2 forces to create a single integrated digital 3 music experience that consumers can access via 4 their PC, portable music device or mobile 5 phone." 6 Do you see that? 7 A. I do. 8 Q. And do you agree with that 9 characterization in that statement? 10 A. Yes. 11 Q. And if you look at the next 12 paragraph, Mr. Krinsky says, "This is an 13 exciting day for us and for music consumers 14 who will now have an easier time than ever 15 before in making music an integral part of 16 their lives wherever they are," right? 17 A. Yes. 18 Q. And if you look down in the next 19 paragraph, second sentence, he says, "As you 20 can imagine, this opens the door for exciting 21 new promotions and opportunities," right? 22 A. Yes.</p>
<p style="text-align: right;">Page 4712</p> <p>1 CHIEF JUDGE SLEDGE: Without 2 objection, it's admitted. 3 (Copyright Owners' Trial Exhibit 4 No. 144 was received into evidence.) 5 BY MR. JOHNSON: 6 Q. Mr. Quirk, who is David Krinsky? 7 A. David Krinsky is a -- I believe his 8 title is senior director of label relations. 9 Q. Okay. 10 A. At the time that he wrote this, he 11 reported to me. 12 Q. Now, in August 2007, Mr. Krinsky 13 wrote to you and others, "I have some very 14 exciting news to share with you," right? I am 15 looking at the first line. 16 A. Oh, well -- what he wrote to me and 17 others was the draft of the e-mail he was 18 planning to send to all his label contacts. 19 Q. Okay. All right. But in this 20 draft e-mail in the next paragraph below what 21 I just read to you, as Mr. Krinsky describes 22 it, he says the following: "Real Networks,</p>	<p style="text-align: right;">Page 4714</p> <p>1 Q. Okay. And this is something that 2 your company was able to achieve after you 3 submitted this written statement to the court, 4 right? 5 A. Yes. 6 Q. Okay. Now -- 7 CHIEF JUDGE SLEDGE: If you're 8 moving on to something else, we will recess 9 for ten minutes. 10 (Recess.) 11 CHIEF JUDGE SLEDGE: Thank you. We 12 will come to order. 13 Mr. Johnson? 14 BY MR. JOHNSON: 15 Q. Mr. Quirk, the last two exhibits. 16 I have placed in front of you Copyright 17 Owners' Exhibits 146 and 147 for 18 identification. Do you see those? 19 A. I do. 20 Q. And do you recognize Exhibit 146 21 for ID as a press release of your company on 22 February 7, 2008, with --</p>

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<p>1 A. I do.</p> <p>2 Q. -- respect to earnings?</p> <p>3 A. Yes.</p> <p>4 Q. And do you recognize Exhibit 147</p> <p>5 for ID as the transcript of an earnings call</p> <p>6 that took place on the same day?</p> <p>7 A. I do.</p> <p>8 Q. And you understand that an earnings</p> <p>9 call is a call that the senior leadership of</p> <p>10 your company has with analysts and investors?</p> <p>11 A. Yes, I do.</p> <p>12 Q. Okay. And this occurred 19 days</p> <p>13 ago, right?</p> <p>14 A. Yes. I'm an English major. It</p> <p>15 takes me a while to do math.</p> <p>16 Q. Now, on February 7, 2008, would you</p> <p>17 characterize your digital music business as</p> <p>18 fragile?</p> <p>19 A. Yes, I would.</p> <p>20 MR. JOHNSON: I offer Exhibits 146</p> <p>21 and 147 into evidence.</p> <p>22 CHIEF JUDGE SLEDGE: Any objection</p>	<p>1 A. Yes.</p> <p>2 Q. Now, up at the top -- by the way,</p> <p>3 Mr. Glaser, the chairman and CEO of Real</p> <p>4 Networks, is the one speaking on that page 4,</p> <p>5 right?</p> <p>6 A. Correct.</p> <p>7 Q. Okay. Now, he is your boss?</p> <p>8 A. Yes.</p> <p>9 Q. Now, if you look at the top</p> <p>10 paragraph of Mr. Glaser's remarks on page 4,</p> <p>11 you will see, "First, let's talk about those</p> <p>12 trends. The writing is on the wall, and the</p> <p>13 entire music industry knows that the future is</p> <p>14 in digital music."</p> <p>15 Do you see that?</p> <p>16 A. I do.</p> <p>17 Q. And if you look further down,</p> <p>18 toward the middle of that paragraph, the</p> <p>19 sentence that begins, "Up until now" --</p> <p>20 A. Yes.</p> <p>21 Q. "Up until now, we were essentially</p> <p>22 cut off from 70 percent of the digital track</p>
Page 4716	Page 4718
<p>1 to Exhibit 146?</p> <p>2 MR. LAGUARDA: No objection to</p> <p>3 Exhibit 146, Your Honor.</p> <p>4 CHIEF JUDGE SLEDGE: Any objection</p> <p>5 to -- well, just a moment. Without objection,</p> <p>6 it's admitted.</p> <p>7 (Copyright Owners' Trial Exhibit</p> <p>8 No. 146 was received into evidence.)</p> <p>9 CHIEF JUDGE SLEDGE: Any objection</p> <p>10 to Exhibit 147?</p> <p>11 MR. LAGUARDA: No objection to</p> <p>12 Exhibit 147, Your Honor.</p> <p>13 CHIEF JUDGE SLEDGE: Without</p> <p>14 objection, it's admitted.</p> <p>15 (Copyright Owners' Trial Exhibit</p> <p>16 No. 147 was received into evidence.)</p> <p>17 BY MR. JOHNSON:</p> <p>18 Q. Mr. Quirk, I want to start with the</p> <p>19 earnings call, 147. And I would like you to</p> <p>20 turn to page 4 of the transcript. The page</p> <p>21 number is down at the bottom right-hand</p> <p>22 corner, shaded.</p>	<p>1 business, the iPod segment, because of DRM</p> <p>2 format incompatibilities."</p> <p>3 Do you see that?</p> <p>4 A. I do.</p> <p>5 Q. All right. That means that record</p> <p>6 owners that were selling to Apple for the</p> <p>7 iPod -- you didn't have access to that up</p> <p>8 until this point --</p> <p>9 A. Not exactly.</p> <p>10 Q. -- in terms of permanent downloads?</p> <p>11 A. We had access to the permanent</p> <p>12 downloads. We did not have access to them in</p> <p>13 a non-DRM format, namely MP3.</p> <p>14 Q. Okay. If you look at the next</p> <p>15 sentence, it says, "However, after a lot of</p> <p>16 cajoling from us and the rest of the digital</p> <p>17 industry, the labels have seen the light and</p> <p>18 all the major labels have now announced that</p> <p>19 they will sell their catalogs in interoperable</p> <p>20 MP3 format."</p> <p>21 That's obviously good news for your</p> <p>22 company, right?</p>

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<p>1 A. Yes.</p> <p>2 Q. And if you look down toward the</p> <p>3 bottom of this particular page, you will see</p> <p>4 reference to the agreements that we earlier</p> <p>5 talked about with MTV. Do you see that?</p> <p>6 A. Yes.</p> <p>7 Q. And there is also a reference to</p> <p>8 the fact that your company is inheriting the</p> <p>9 subscription music business from Yahoo!,</p> <p>10 right?</p> <p>11 A. Correct.</p> <p>12 Q. Okay. And when did that happen?</p> <p>13 A. It was announced -- it might have</p> <p>14 been this same day or a few days beforehand.</p> <p>15 It was earlier in February it was announced.</p> <p>16 Q. That's also good news for your</p> <p>17 company, right?</p> <p>18 A. It is, yes.</p> <p>19 Q. All right. Would you look at 146,</p> <p>20 please? 146 is entitled, "Real networks</p> <p>21 announces fourth quarter and full year 2007</p> <p>22 results." This is dated February 7, 2008,</p>	<p>1 A. Correct.</p> <p>2 Q. And if you look further down in</p> <p>3 that paragraph you see a revenue number for</p> <p>4 music, right?</p> <p>5 A. Yes.</p> <p>6 Q. And that's your business, right?</p> <p>7 A. Yes.</p> <p>8 Q. And the revenue number for music is</p> <p>9 a 21 percent increase from the fourth quarter</p> <p>10 of the year before, right?</p> <p>11 A. Correct.</p> <p>12 Q. Look at the next page, please, down</p> <p>13 at the bottom, full year 2007 results.</p> <p>14 A. Uh-huh.</p> <p>15 Q. You will see there the statement</p> <p>16 reads, "For 2007, revenue grew 44 percent to</p> <p>17 567.6 million compared to 395.3 million for</p> <p>18 2006."</p> <p>19 That's for the company as a whole,</p> <p>20 right?</p> <p>21 A. Correct.</p> <p>22 Q. And you also see that for music</p>
Page 4720	Page 4722
<p>1 correct?</p> <p>2 A. Yes.</p> <p>3 Q. And if you look at the bottom full</p> <p>4 paragraph there -- well, actually, if you look</p> <p>5 at the preceding paragraph, the statement</p> <p>6 reads, "2007 was a strong year for Real</p> <p>7 Networks."</p> <p>8 This is your company in its</p> <p>9 entirety, right?</p> <p>10 A. Yes.</p> <p>11 Q. This statement is not limited to</p> <p>12 the music business, right?</p> <p>13 A. Correct.</p> <p>14 Q. Okay. But the statement is strong</p> <p>15 year for Real Networks in 2007, right?</p> <p>16 A. Yes.</p> <p>17 Q. Okay. If you look down at the</p> <p>18 paragraph below that, you will see for the</p> <p>19 fourth quarter of 2007 revenue grew 25 percent</p> <p>20 to 1. -- I'm sorry -- to 156.9 million</p> <p>21 compared with 125.6 million for the fourth</p> <p>22 quarter of '06, right?</p>	<p>1 there was a 21 percent revenue increase for</p> <p>2 the full year of 2007 as compared to 2006,</p> <p>3 right?</p> <p>4 A. Correct.</p> <p>5 Q. And if you look at the next page</p> <p>6 you will see that your company, for 2008,</p> <p>7 expects revenue in the range of 612 million to</p> <p>8 632 million, right?</p> <p>9 A. Yes.</p> <p>10 Q. That's an increase from revenue of</p> <p>11 2007 of 567.6 million, right?</p> <p>12 A. Yes.</p> <p>13 MR. JOHNSON: I have no further</p> <p>14 questions.</p> <p>15 CHIEF JUDGE SLEDGE: Any questions</p> <p>16 by RIAA?</p> <p>17 MR. FREEDMAN: No, Your Honor.</p> <p>18 CHIEF JUDGE SLEDGE: Any redirect?</p> <p>19 MR. LAGUARDA: No, Your Honor.</p> <p>20 CHIEF JUDGE SLEDGE: Questions from</p> <p>21 the bench?</p> <p>22 Thank you, sir. That ends your</p>

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<p style="text-align: right;">Page 4723</p> <p>1 testimony.</p> <p>2 THE WITNESS: Thank you.</p> <p>3 (Witness excused.)</p> <p>4 MR. LAGUARDA: Your Honor, this</p> <p>5 concludes the witnesses and the presentation</p> <p>6 of DiMA's direct case.</p> <p>7 I believe at this time the RIAA has</p> <p>8 a witness.</p> <p>9 CHIEF JUDGE SLEDGE: Mr. Handzo?</p> <p>10 MR. HANDZO: Thank you, Your Honor.</p> <p>11 The RIAA will call as its final witness</p> <p>12 Mr. David Munns.</p> <p>13 CHIEF JUDGE SLEDGE: Mr. Munns,</p> <p>14 please raise your right hand.</p> <p>15 Whereupon,</p> <p>16 DAVID MUNNS,</p> <p>17 called for examination by counsel, and having</p> <p>18 been sworn by the Chief Judge, was examined</p> <p>19 and testified as follows:</p> <p>20 CHIEF JUDGE SLEDGE: Thank you,</p> <p>21 sir. Please be seated.</p> <p>22 ///</p>	<p style="text-align: right;">Page 4725</p> <p>1 American operation, would that be recorded</p> <p>2 music or music publishing or both?</p> <p>3 A. No, just recorded music, not</p> <p>4 publishing.</p> <p>5 Q. And -- I'm sorry. How long did you</p> <p>6 have that position?</p> <p>7 A. I had that position for five years,</p> <p>8 just slightly over five years.</p> <p>9 Q. Mr. Munns, we put in front of you</p> <p>10 what we have marked as RIAA Trial Exhibit 76.</p> <p>11 Can you identify that for us, please?</p> <p>12 A. Yes. That's my testimony.</p> <p>13 Q. And is that accurate, sir?</p> <p>14 A. Yes, it is.</p> <p>15 MR. HANDZO: Your Honor, I would</p> <p>16 move RIAA Trial Exhibit 76 into evidence.</p> <p>17 CHIEF JUDGE SLEDGE: Any objection?</p> <p>18 MR. COHEN: No, Your Honor.</p> <p>19 CHIEF JUDGE SLEDGE: Without</p> <p>20 objection, it's admitted.</p> <p>21 (RIAA Trial Exhibit No. 76 was</p> <p>22 received into evidence.)</p>
<p style="text-align: right;">Page 4724</p> <p>1 DIRECT EXAMINATION</p> <p>2 BY MR. HANDZO:</p> <p>3 Q. Sir, could you introduce yourself</p> <p>4 to the court, please.</p> <p>5 A. My name is David Munns. Until a</p> <p>6 year ago I was the worldwide vice chairman of</p> <p>7 EMI Recorded Music division and the CEO of the</p> <p>8 North American business.</p> <p>9 Q. Where are you currently employed?</p> <p>10 A. Currently employed in the -- I'm a</p> <p>11 music consultant in the U.K.</p> <p>12 Q. While you were with EMI in the</p> <p>13 positions that you just described, what were</p> <p>14 your responsibilities?</p> <p>15 A. With my vice chairman's hat on, all</p> <p>16 the senior executives in the record world in</p> <p>17 EMI reported jointly to myself and the</p> <p>18 chairman. And in the -- with my CEO of North</p> <p>19 America hat on, I ran the North American</p> <p>20 operation and all the executives reported to</p> <p>21 me there.</p> <p>22 Q. When you say you ran the North</p>	<p style="text-align: right;">Page 4726</p> <p>1 MR. HANDZO: Your Honor, there is</p> <p>2 one number in this document for which we would</p> <p>3 ask restricted treatment under the protective</p> <p>4 order. It appears on page 5. In the second</p> <p>5 to last line there is a figure there on the</p> <p>6 percentage of profitability of ring tones that</p> <p>7 generate enough revenue to cover costs. And</p> <p>8 that is something that the company regards as</p> <p>9 competitively sensitive data.</p> <p>10 CHIEF JUDGE SLEDGE: Any objection?</p> <p>11 MR. COHEN: No, Your Honor.</p> <p>12 CHIEF JUDGE SLEDGE: The motion is</p> <p>13 granted.</p> <p>14 BY MR. HANDZO:</p> <p>15 Q. Mr. Munns, in your written</p> <p>16 testimony, among other things, you talk about</p> <p>17 the cost of digital distribution. I just want</p> <p>18 to focus on a couple of things there. One of</p> <p>19 the things that you talk about is having to</p> <p>20 maintain both a physical distribution system</p> <p>21 and a digital distribution system. Why is</p> <p>22 that a problem?</p>

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